NO. 1500-100 | OCTOBER 9, 2006

Financial Accounting Series

EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards

Not-for-Profit Organizations: Mergers and Acquisitions

a replacement of APB Opinion No. 16 and related interpretive guidance provided in AICPA Audit and Accounting Guides, *Not-for-Profit Organizations,* and *Health Care Organizations*

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Technical Director
File Reference No. 1500-100

Comment Deadline: January 29, 2007

Financial Accounting Standards Board
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be **received** in writing by January 29, 2007. Interested parties should submit their comments by email to director@fasb.org, File Reference 1500-100. Those without email may send their comments to the "Technical Director—File Reference 1500-100" at the address at the bottom of this page. Responses should **not** be sent by fax.

All comments received are considered public information. Those comments will be posted to the FASB's website and will be included in the project's public record.

An electronic copy of this Exposure Draft is available on the FASB's website until the FASB issues a final document. Any individual or organization may obtain one copy of this Exposure Draft without charge until January 29, 2007, on written request only. *Please ask for our Product Code No. E190.* For information on applicable prices for additional copies and copies requested after January 29, 2007, contact:

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

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

Notice for Recipients of This Exposure Draft

The accounting for mergers and acquisitions may significantly affect the reported financial position and activities of a not-for-profit organization in both the current period and future periods. Existing standards require the use of one of two different methods of accounting that produce dramatically different financial statement results for economically similar transactions and events. This proposed Statement would eliminate the use of the pooling-of-interests (pooling) method of accounting by not-for-profit organizations and would require that not-for-profit organizations apply the acquisition method to any merger or acquisition. Use of the acquisition method would improve financial reporting because it produces financial information that more faithfully reflects the underlying economics of those events and increases the comparability of the financial results of not-for-profit organizations.

Request for Comments

The Board invites comments on all matters in this proposed Statement, particularly on the issues discussed below. Respondents need not comment on each issue and are encouraged to comment on additional matters they believe should be brought to the Board's attention. It would be helpful if comments explain the reasons for the positions taken and include any alternatives the Board should consider. Respondents must submit comments in writing by January 29, 2007.

The overall approach on this project has been that the standards for for-profit entities, including changes in proposed FASB Statement, *Business Combinations*, referred to in this proposed Statement as proposed Statement 141(R), are relevant to not-for-profit organizations unless circumstances unique to not-for-profit organizations justify a departure from those requirements. Because of the relationship between this project and the Board's project on business combinations, readers can refer to the FASB website for the Board's conclusions on its project, Business Combinations: Applying the Acquisition Method, to gain insight about which portions of this proposed Statement may change, independent of the comments received on this Exposure Draft. Notwithstanding the Board's ongoing discussion on its project on business combinations, the Board requests that respondents provide comments on how the provisions of this proposed Statement would apply to not-for-profit organizations.

Objectives

This proposed Statement would provide guidance on the accounting and reporting for a not-for-profit organization upon initial recognition of another entity or a business or nonprofit activity in its financial statements as a result of a merger or acquisition. It would apply to a merger of a not-for-profit organization's net assets with those of one or more other organizations, as well as an acquisition of a business or nonprofit activity by purchase, contribution, or other means. The objectives of a not-for-profit organization in applying this proposed Statement are to:

a. Recognize the identifiable assets acquired and liabilities assumed that compose the business or nonprofit activity acquired in a merger or acquisition, with certain exceptions.
b. Measure those assets and liabilities at their fair values as of the acquisition date, with certain exceptions.
c. Recognize either goodwill of the acquired business or nonprofit activity or the contribution inherent in the merger or acquisition as follows:
    (1) Measure goodwill as the amount by which the value of the consideration transferred (if any) exceeds the net of the amounts assigned to identifiable assets acquired and liabilities assumed.
    (2) Measure the contribution inherent in the transaction as the amount by which the values assigned to the identifiable assets acquired exceeds the consideration transferred (if any) and the liabilities assumed.
d. Disclose information to enable users of the financial statements to evaluate the nature and financial effects of the merger or acquisition. [paragraph 1]

The Board believes that virtually all mergers or acquisitions are, in substance, the acquisition of net assets. The Board believes that in meeting those objectives, a not-for-profit organization will produce financial information that better reflects the economic substance of a merger or acquisition, which better meets the information needs of users of that information.

(See paragraph 1 for the related requirements and paragraphs B24–B45 for the basis for the Board's conclusions.)

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?

Scope and Definitions

This proposed Statement would define a merger or acquisition by a not-for-profit organization as follows:

> . . . any event that results in the initial recognition of another business or nonprofit activity (acquiree) in the financial statements of a not-for-profit organization. [paragraph 2]

Thus, any event that requires a not-for-profit organization to consolidate a previously unconsolidated entity is a merger or acquisition and would be accounted for in accordance with the guidance in this proposed Statement. This proposed Statement would retain the existing guidance used by a not-for-profit organization in determining whether another entity should be consolidated. That guidance, which includes AICPA Statement of Position (SOP) 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*, and AICPA Audit and Accounting Guide, *Health Care Organizations*, describes circumstances in which consolidation is not required or is prohibited. This proposed Statement would **not** change that existing guidance.

(See paragraphs 2–6 for the related requirements and paragraphs B46–B50 for the basis for the Board's conclusions.)

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?

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?

This proposed Statement distinguishes between an acquisition of a business or nonprofit activity and a purchase or contribution of a group of assets. This proposed Statement would define a *business* and a *nonprofit activity* as follows:

> A *business* is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing economic benefits in the form of a return to investors. Those returns are reflected in the market price of the equity interests or through dividends or through other forms, such as lower costs that are provided directly and proportionately to owners, members, or participants. A business often is, but need not be, a separate legal entity. [paragraph 4(d)]
>
> 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. [paragraph 4(p)]

The definition of a business is consistent with the definition in proposed Statement 141(R).

(See paragraphs 4(d), 4(p), and paragraphs A2–A7 for the related requirements and paragraphs B51–B54 for the basis for the Board's conclusions.)

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?*

Identifying an Acquirer

This proposed Statement would require the identification of an acquirer in all mergers or acquisitions. This proposed Statement would require that the acquirer be the organization that obtains control and recognizes the acquiree in its financial statements. Determining whether an organization obtains control of an acquiree would be based on existing guidance, including SOP 94-3 and the health care Guide. If an acquirer cannot be determined based solely on that guidance, this proposed Statement would require that the factors provided in paragraph 11 be considered.

(See paragraphs 9–12 and A8 for the related requirements and paragraphs B58–B60 for the basis for the Board's conclusions.)

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?

Recognizing and Measuring the Identifiable Assets Acquired and Liabilities Assumed

This proposed Statement would require a not-for-profit acquirer to recognize (with certain exceptions) the identifiable assets acquired and liabilities assumed that compose the acquiree and to measure them at their acquisition date fair values.

(See paragraphs 15–36 for the related requirements and paragraphs B62–B118 for the basis for the Board's conclusions.)

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?

Recognition of Identifiable Assets Apart from Goodwill and Departures from Those Requirements

This proposed Statement would require the acquirer to recognize separately the acquisition date fair values of **identifiable** intangible assets acquired in a merger or acquisition, with the exception of an assembled workforce. An intangible asset is identifiable if it either:

a. Arises from contractual or other legal rights regardless of whether they are separable from the entity (the contractual-legal criterion); or
b. Is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged (regardless of whether there is an

intent to do so) either individually or in combination with a related contract, asset, or liability (the separability criterion).

That requirement, which is consistent with proposed Statement 141(R), would include separate recognition of donor-related intangible assets acquired in a merger or acquisition that meet either the contractual-legal criterion or the separability criterion.

For cost-benefit reasons and for simplicity, this proposed Statement would require exceptions from the requirement to recognize and measure the identifiable assets acquired and liabilities assumed at their acquisition date fair values. Certain identifiable assets acquired and liabilities assumed would continue to be recognized in accordance with other GAAP, including:

a. Certain inexhaustible collection items
b. Conditional promises to give
c. Operating leases
d. Assets held for sale
e. Deferred taxes
f. Pension and other postemployment benefits.

(See paragraphs 17, 25–29, 34–36, and A9–A41 for the related requirements and paragraphs B66–B76, B80–B89, B93–B102 for the basis for the Board's conclusions.)

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?

Question 8—Are the departures from recognition and measurement requirements in this proposed Statement appropriate accommodations to avoid the added difficulties and costs that would be incurred? If those accommodations are not appropriate, which exceptions would you add or eliminate and why?

Question 9—Are there other types of identifiable intangible assets that are prevalent in not-for-profit organizations that should be included as examples in Appendix A?

Recognizing and Measuring the Goodwill or the Contribution Received

This proposed Statement also would require that the acquirer recognize either the goodwill purchased or the contribution inherent in the merger or acquisition. The requirement to recognize inherent contributions is consistent with FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, which requires that contributions received be recognized as assets (or reductions in liabilities). In some mergers or acquisitions, an acquirer may receive either a full contribution or a partial contribution of an acquiree. Current practice often results in no recognition of goodwill or contributions received in a merger or acquisition. Thus, the application of this proposed Statement would result in additional information about the goodwill acquired and contributions received.

This proposed Statement would require that goodwill and the contribution received be calculated and measured as a residual value rather than measured at fair value. Goodwill would be measured as the amount by which the fair value of the consideration transferred (if any) exceeds the net of the acquisition date values of the identifiable assets acquired and liabilities assumed. The contribution inherent in the merger or acquisition would be measured as the amount by which the acquisition date values of the identifiable assets acquired exceed the consideration transferred (if any) and the liabilities assumed. The acquisition date values refer to the amounts assigned to recognized assets and liabilities as would be required by this proposed Statement, which, with limited exceptions, is fair value at the acquisition date. Therefore, the acquirer would **not** be required to measure the fair value of the acquiree as a whole. This proposed Statement would require departures from proposed Statement 141(R) for the measurement of goodwill and the contribution received to avoid the difficulties and costs that otherwise would be incurred to measure certain acquirees' acquisition date fair values and for simplicity. That requirement could result in recognition of less goodwill and less contribution revenue in those acquisitions that are in the form of a contribution.

(See paragraphs 37–50 for the related requirements and paragraphs B119–B155 for the basis for the Board's conclusions.)

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?

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?

Measurement Period

This proposed Statement would provide a period after the acquisition date during which the acquirer may adjust provisional amounts recognized at the acquisition date. That measurement period would end when the acquirer receives the necessary information about facts and circumstances that existed at the acquisition date, when the acquirer learns the information is unobtainable, or within one year from the acquisition date, whichever occurs first.

The objective of the measurement period is to provide the acquirer a reasonable amount of time to obtain the information necessary to identify and measure all the assets acquired, liabilities assumed, and consideration transferred.

(See paragraphs 52–57 and A54–A62 for the related requirements and paragraphs B158 and B159 for the basis for the Board's conclusions.)

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?

Assessing What Is Part of the Merger or Acquisition

This proposed Statement would require an acquirer to assess whether multiple transactions should be bundled together. For example, an acquirer may transfer consideration in exchange for the acquiree, as well as consideration to compensate the acquiree's employees for future services. Only the consideration transferred by (or on behalf of) the acquirer for the acquiree and the assets acquired or liabilities assumed that are part of the acquiree would be included in the acquisition accounting. This proposed Statement would provide guidance for making the required assessment.

(See paragraphs 58–60 and A63–A73 for the related requirements and paragraphs B77–B79 and B155 for the basis for the Board's conclusions.)

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?

Disclosures

This proposed Statement includes broad disclosure objectives to ensure that users of financial statements have adequate information to evaluate:

a. The nature and financial effect of mergers and acquisitions that occur during the reporting period and that occur after the balance sheet date but before the financial statements are issued (paragraph 64)
b. The financial effects of adjustments recognized in the current reporting period relating to mergers and acquisitions that were effected in the current or previous reporting periods (paragraph 69)
c. The changes in the carrying amount of goodwill during the reporting period (paragraph 71).

Those objectives would be supplemented by specific minimum disclosure requirements. In most instances, the objectives would be met by the minimum disclosure requirements. However, in some circumstances, an acquirer might be required to disclose additional information necessary to meet the disclosure objectives.

(See paragraphs 64–75 for the related requirements and paragraphs B167–B177 for the basis for the Board's conclusions.)

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?

Disclosures by Public Entities

A not-for-profit organization that is a public entity, such as one that issues public debt securities or is obligated for public conduit debt securities issued by a governmental issuer, also would be required to disclose information about the operations of:

a. The acquiree following the acquisition date
b. The consolidated organization as if the acquisition had occurred as of the beginning of the annual reporting period.

If the disclosure of that information would be impracticable, the acquirer would be required to disclose that fact and the reasons why that disclosure is impracticable.

(See paragraphs 67 and 68 for the related requirements and paragraphs B170–B177 for the basis for the Board's conclusions.)

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?

Noncontrolling Ownership Interests in a Subsidiary

This proposed Statement would define a noncontrolling ownership interest in the consolidated financial statements of a not-for-profit organization (parent) as the portion of the equity (net assets or residual interest) in a subsidiary attributable to the owners of the subsidiary other than the parent and the parent's affiliates. This proposed Statement would establish standards for the accounting and reporting of noncontrolling ownership interests in the consolidated financial statements of a not-for-profit organization and for the loss of control of subsidiaries.

Noncontrolling ownership interests would be required to be presented as a separate component of the appropriate class of net assets in the consolidated financial statements of a not-for-profit organization.

a. **Attribution of changes in the consolidated net assets.** Changes in the consolidated net assets would be attributed to the controlling and noncontrolling ownership interests based on relative ownership interests, unless the controlling and noncontrolling ownership interests have entered into a contractual arrangement that requires a different attribution between them.
b. **Changes in the ownership interests.** Changes in ownership that do not result in a loss of control and deconsolidation of a subsidiary would be reported as a separate line item in the consolidated statement of activities. If a not-for-profit organization loses control of a subsidiary, any gain or loss would be recognized in its consolidated statement of activities.

(See Appendix D for the related requirements and paragraphs B156 and B157 for the basis for the Board's conclusions.)

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?

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?

Benefits and Costs of the Proposed Requirements

The Board believes that the requirements of this proposed Statement would result in improved financial reporting in several ways:

a. Accounting for all mergers and acquisitions by not-for-profit organizations using a single method would improve the comparability of the reported financial information.
b. Requiring an acquirer to recognize identifiable intangible assets apart from goodwill would provide more complete financial information about the assets acquired and liabilities assumed in mergers and acquisitions.
c. Requiring an acquirer to recognize the identifiable assets acquired and liabilities assumed at their acquisition date fair values would better reflect the value of the assets received and liabilities assumed.
d. Requiring an acquirer to recognize a contribution received in circumstances in which the sum of the fair values of the identifiable assets acquired exceed the fair values of the liabilities assumed and any consideration transferred would better reflect the contributions that are received in some mergers and acquisitions by not-for-profit organizations.
e. Requiring an acquirer to disclose information about the nature and financial effect of mergers and acquisitions would provide useful information to resource providers and other users in evaluating the financial effects of a transaction.

The Board sought to reduce the costs of applying the requirements of this proposed Statement without significantly reducing the expected benefits. The Board believes that this proposed Statement would do that by requiring that:

a. Goodwill or a contribution received be measured by comparing the acquisition date values of the identifiable assets acquired to the acquisition date values of the liabilities assumed and any consideration transferred in exchange for the acquiree.
b. Particular assets and liabilities (for example, those related to certain collection items, deferred taxes, pensions, and other postemployment benefits) continue to be recognized and measured in accordance with existing accounting standards rather than at fair value.
c. Its provisions be applied prospectively rather than retrospectively.

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?

Public Roundtable Meetings

The Board plans to hold one or more public roundtable meetings in Norwalk, Connecticut, on March 27, 2007, to discuss this Exposure Draft and the FASB Exposure Draft, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition.* The purpose of roundtable meetings is to listen to the views of, and obtain information from, interested constituents about the two Exposure Drafts. The Board plans to seek participants for the meetings that represent a wide variety of constituents to ensure that it receives broad input.

Any individual or organization wishing to participate in the public roundtable meeting(s) must notify the FASB by sending an email to **director@fasb.org** by January 29, 2007, and must submit comments on the Exposure Drafts in writing by January 29, 2007. Roundtable meetings can accommodate a limited number of participants. Depending on the number of responses received, the Board may not be able to accommodate all requests to participate.

Summary

This proposed Statement would improve financial reporting by not-for-profit organizations that engage in mergers and acquisitions by requiring accounting that reflects more faithfully the underlying economics of those events. In particular, application of this proposed Statement would result in financial statements that:

a. **Provide more relevant information by reflecting the current value of the assets acquired and liabilities assumed.** Financial information would be more relevant because an acquirer would recognize the assets acquired and liabilities assumed at their acquisition date fair values, with limited exceptions. That would be the case regardless of whether those assets were acquired and liabilities were assumed as the result of a merger, purchase, contribution, or other means. Currently, not-for-profit organizations account for many mergers or acquisitions by the pooling-of-interests (pooling) method, in which assets acquired and liabilities assumed are recorded at "carryover" amounts.
b. **Provide more complete financial information.** Financial information would be more complete because an acquirer would recognize many acquired intangible assets separately from goodwill. The pooling method of accounting precludes the recognition of many intangible assets, and the present application of the purchase method (now called the acquisition method) often fails to recognize certain identifiable intangible assets separate from goodwill.
c. **Better reflect inherent contributions received in a merger or acquisition by a not-for-profit organization, if any.** Many mergers and acquisitions involving not-for-profit organizations do not involve a transfer of consideration; instead, they represent the contribution of one organization to another, either in whole or in part. Under this proposed Statement, an acquirer would recognize the inherent contribution received in such transactions.

Reasons for Issuing This Proposed Statement

The Board issued this proposed Statement to replace the limited existing guidance on accounting and reporting by a not-for-profit organization that merges with or acquires another entity or a business or nonprofit activity.

Not-for-profit organizations currently account for a merger or acquisition by analogizing to the requirements in APB Opinion No. 16, *Business Combinations*, that were developed specifically for use by business entities. That Opinion was superseded for business entities with the issuance of FASB Statement No. 141, *Business Combinations.* Opinion 16 requires the use of one of two alternative methods of accounting for mergers and acquisitions—the pooling method and the acquisition method. Many mergers and acquisitions by not-for-profit organizations are currently accounted for in a manner similar to the pooling method, particularly those that occur without a transfer of consideration. Under the pooling method, the newly combined organization carries forward the carrying amounts of assets and liabilities recognized in the statements of financial position of each of the consolidating entities. Under the acquisition method, assets acquired and liabilities assumed are reported at current values rather than at historical cost carrying values.

The Board believes the information provided by the pooling method is less decision useful than that provided by the acquisition method. Moreover, the pooling method is inconsistent with the general accounting for asset acquisitions by not-for-profit organizations. That is, the assets acquired are generally recognized at a current or fair value regardless of whether a not-for-profit organization acquires assets by contribution or by purchase. The pooling method is an anomaly in the accounting for asset acquisitions by not-for-profit organizations. Therefore, this proposed Statement would eliminate that method.

While many aspects of mergers and acquisitions between not-for-profit organizations are similar to business combinations, some aspects are different. For example, many mergers or acquisitions by not-for-profit organizations do not involve an exchange of consideration other than the assumption of the acquiree's liabilities. That is, the substance of those transactions is a contribution of one entity to another either in whole or in part. The existing accounting guidance often fails to recognize the contributions inherent in those transactions.

How the Conclusions in This Proposed Statement Relate to the Conceptual Framework

The Board concluded that virtually all mergers and acquisitions, including those by not-for-profit organizations, are economically similar transactions (the acquisition of assets). Thus, requiring one method of accounting for those economically similar transactions is consistent with providing information that faithfully represents those transactions. As discussed in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* a faithful representation of a transaction possesses the qualities of being comparable to similar transactions and understandable.

This proposed Statement's requirement to recognize and measure the identifiable assets acquired and liabilities assumed at their fair values would improve the relevance and reliability of financial information. Concepts Statement 2 explains that those are the primary qualities that make accounting information decision useful.

This proposed Statement's broad requirements to disclose adequate information about mergers and acquisitions would be useful to resource providers and other users in evaluating the financial effects of a merger or acquisition. FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations,* explains that financial reporting should provide information about the economic resources, obligations, and net resources of an organization and the effects of transactions, events, and circumstances that change resources and interests in those resources. Consistent with Concepts Statement 4, that type of information is useful in making resource allocation decisions, in assessing services and the ability to provide services, and in assessing management's stewardship and performance.

Benefits and Costs

As discussed in Concepts Statement 4, the objective of financial reporting by a not-for-profit organization is to provide information that is useful to present and potential resource providers and other users in making rational decisions about the allocation of resources to that organization. The Board recognizes that the benefits of providing information for that purpose should justify the related costs of preparing it. The Board concluded that the benefits resulting from the improvements in financial reporting that this proposed Statement would provide outweigh the costs of implementation.

The Board believes that the requirements of this proposed Statement would improve financial reporting in several ways. The Board expects that the issuance of this proposed Statement would result in more complete and comparable financial information. The requirement to measure assets acquired and liabilities assumed at their acquisition date fair values (with limited exceptions) would provide more relevant information to users of financial statements and would reflect a contribution inherent in the transaction in a manner similar to any other contribution received (at the fair value of the asset received).

The Board sought to reduce the costs of applying this proposed Statement without significantly reducing the expected benefits. The Board believes that this proposed Statement would do that by:

a. Not requiring measurement of the acquisition date fair value of the acquiree as a whole. Rather, goodwill and contributions received would be recognized and measured by comparing the acquisition date fair values of the identifiable assets acquired, liabilities assumed, and any consideration transferred in exchange for the acquiree.
b. Requiring that certain assets and liabilities be exempt from recognition (for example, those related to certain inexhaustible collection items and conditional promises to give) and requiring that others be measured in accordance with existing standards rather than fair value (such as deferred taxes and obligations to provide defined benefit pension or other postemployment benefits).
c. Applying its provisions prospectively rather than retrospectively.

Effective Date

A not-for-profit organization would be required to apply the provisions in this proposed Statement prospectively in its fiscal year that begins approximately six months after the issuance of a final Statement. For example, if a final Statement is issued on June 30, 2007, its application would be required in fiscal years beginning after December 15, 2007. Earlier application would be encouraged for organizations with annual periods that begin on or after the date a final Statement is issued. The Board expects that this proposed Statement would be effective at the same time as the provisions in proposed FASB Statement, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition.*

Proposed Statement of Financial Accounting Standards

Not-for-Profit Organizations: Mergers and Acquisitions

October 9, 2006

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Proposed Statement of Financial Accounting Standards

Not-for-Profit Organizations: Mergers and Acquisitions

October 9, 2006

OBJECTIVES

1. This Statement provides guidance on the accounting and financial reporting for mergers and acquisitions by a not-for-profit organization. The objectives of a not-for-profit organization in applying this Statement are to:

a. Recognize the identifiable assets acquired and liabilities assumed that compose the business or nonprofit activity acquired in a merger or acquisition, with certain exceptions.
b. Measure those assets and liabilities at their fair values as of the acquisition date, with certain exceptions.
c. Recognize either goodwill of the acquired business or nonprofit activity or the contribution inherent in the merger or acquisition as follows:
    (1) Measure goodwill as the amount by which the value of the consideration transferred (if any) exceeds the net of the amounts assigned to identifiable assets acquired and liabilities assumed.
    (2) Measure the contribution inherent in the transaction as the amount by which the values assigned to the identifiable assets acquired exceeds the consideration transferred (if any) and the liabilities assumed.
d. Disclose information to enable users of the financial statements to evaluate the nature and financial effects of the merger or acquisition.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

2. A not-for-profit organization shall apply this Statement in accounting for a merger or acquisition except when that merger or acquisition is between entities under common control. For purposes of this Statement, a merger or acquisition is any event that results in the initial recognition of another business or nonprofit activity (acquiree) in the financial statements of a not-for-profit organization. Thus, any event that requires an organization to consolidate a previously unconsolidated entity by initially recognizing its net assets is a merger or acquisition. Paragraphs 5 and 6 provide guidance to assist a not-for-profit organization in identifying a merger or acquisition.

3. This Statement does not apply to mergers or acquisitions between entities under common control. Sometimes, an organization's mission, operations, and historical sources of support may be closely linked to benefiting a particular group of citizens. However, that group neither owns nor controls that not-for-profit organization. Therefore, mergers and acquisitions between or among two or more organizations, all of which

benefit a particular group of citizens, should not be considered common control transactions solely because those organizations benefit a particular group.

Key Terms

4. The following terms are used with specific meanings for the purpose of this Statement and are integral to understanding and applying this Statement.

a. The *acquiree* is the business or nonprofit activity that the acquirer obtains control of in a merger or acquisition.
b. The *acquirer* is the organization that obtains control of the acquiree and recognizes the acquiree in its financial statements.
c. The *acquisition date* is the date the acquirer initially recognizes the net assets of the acquiree in its financial statements.
d. A *business* is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing economic benefits in the form of a return to investors. Those returns are reflected in the market price of the equity interests or through dividends or through other forms, such as lower costs that are provided directly and proportionately to owners, members, or participants. A business often is, but need not be, a separate legal entity.
e. *Collections* are works of art, historical treasures, or similar assets that are:
   (1) Held for public exhibition, education, or research to further public service rather than financial gain;
   (2) Protected, kept unencumbered, cared for, and preserved; and
   (3) Subject to an organizational policy that requires the proceeds of items that are sold to be used to acquire other items for collections (paragraph 209 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*).
f. A *conditional promise to give* is a promise to give that depends on the occurrence of a specified future and uncertain event to bind the promisor (paragraph 209 of Statement 116). A promise reflects a clear duty or requirement of the promisor to transfer promised assets in the future at a specified or determinable date or, if conditional, upon occurrence of a specified event (paragraph 94 of Statement 116).
g. *Contingencies* are existing conditions, situations, or sets of circumstances involving uncertainty as to possible gain or loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur (paragraph 1 of FASB Statement No. 5, *Accounting for Contingencies*).
h. 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.

i. *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*).

j. *Equity interest* is used broadly to mean ownership interests of investor-owned entities; owner, member, or participant interests of mutual entities; and ownership interests in the net assets of not-for-profit organizations.

k. *Fair value* is "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date" (paragraph 5 of FASB Statement No. 157, *Fair Value Measurements*). Paragraph 10 of Statement 157 defines market participants as:

> . . . buyers and sellers in the principal (or most advantageous) market for the asset or liability that are:
>
> a. Independent of the reporting entity; that is, they are not related parties
> b. Knowledgeable, having a reasonable understanding about the asset or liability and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary
> c. Able to transact for the asset or liability
> d. Willing to transact for the asset or liability; that is, they are motivated but not forced or otherwise compelled to do so. [Footnote reference omitted.]

l. *Goodwill* is the future economic benefits arising from assets that are not individually identified and separately recognized. This Statement requires that an acquirer measure goodwill of the acquiree as a residual.

m. An *identifiable asset* is an asset, distinguished from goodwill, that either:
   (1) Is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged either individually or together with a related contract, asset, or liability, regardless of whether the entity intends to do so; or
   (2) Arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

n. *Noncontrolling ownership interest* is the portion of the equity (residual interest) in a subsidiary attributable to the owners of the subsidiary other than the parent and the parent's affiliates (paragraph 5(e) of proposed FASB Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*).

o. A *not-for-profit organization* is an entity that possesses the following characteristics that distinguish it from a for-profit business entity:

(1) Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
(2) Operating purposes other than to provide goods or services at a profit
(3) Absence of ownership interests with characteristics that are similar to those of a for-profit business entity.

Not-for-profit organizations have those characteristics in varying degrees. Organizations that fall outside this definition include all investor-owned entities and entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance companies, credit unions, farm and rural electric cooperatives, and employee benefit plans (paragraph 209 of Statement 116).

p. 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.

q. A *public entity* is an entity that has issued debt or equity securities or is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets), that is required to file financial statements with the Securities and Exchange Commission, or that provides financial statements for the purpose of issuing any class of securities in a public market.

Conduit debt securities refers to certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing financing for a specific third party that is not a part of the state or local government's financial reporting entity. Although conduit debt securities bear the name of the governmental issuer, the governmental issuer has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf they are issued.[1]

r. *Owner* is used broadly to include holders of equity interests of investor-owned entities; owners, members, or participants of mutual entities; and ownership interests in the net assets of not-for-profit organizations.

Identifying a Merger or Acquisition

5. A merger or acquisition is any transaction or other event that results in a not-for-profit organization initially recognizing a business or nonprofit activity in its financial

[1]The Board plans to issue in the fourth quarter of 2006 a final FASB Staff Position (FSP) that revises the definition of a public entity to include an obligor for conduit debt securities. The definition of a public entity may change in that final FSP.

statements. 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:

a. An organization legally merges with one or more not-for-profit organizations into a single, surviving organization. In a legal merger, the surviving organization becomes the owner of all of the assets and assumes all of the obligations of each party to the merger.
b. An organization receives by contribution a group of assets (or a group of assets and liabilities) that constitutes a business or nonprofit activity.
c. An organization purchases the assets and assumes the liabilities that constitute a business or nonprofit activity in exchange for cash or other assets.
d. An organization obtains control of and initially 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 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.

6. Examples of transactions that are **not** mergers and acquisitions as defined by this Statement include the following:

a. An organization obtains control of another entity, but does not consolidate that entity, as permitted or required by SOP 94-3[2] or the health care Guide. As discussed in SOP 94-3 and the health care Guide, the various kinds and combinations of control and economic interest result in various financial reporting. Certain kinds of control result in consolidation. Other kinds of control result in consolidation only if coupled with an economic interest. Still other kinds of control result in consolidation being permitted, but not required, if coupled with an economic interest. 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.

[2]See paragraphs 8–14 of SOP 94-3 for related guidance.

b. An organization participates in the formation of a joint venture[3] under joint control. That transaction is not a merger or acquisition because the organization does not control and consolidate the venture.

c. An organization acquires a group of assets and liabilities that does not constitute a business or nonprofit activity as defined by this Statement (paragraphs A2–A7 provide additional guidance about the definition and elements of a business or nonprofit activity). That transaction is not a merger or acquisition because the acquired group of assets is not a business or nonprofit activity.

The Acquisition Method

7. A not-for-profit organization shall account for a merger or acquisition by applying the acquisition method described in this Statement.

8. The acquisition method has four steps:

a. Identify the acquirer.
b. Determine the acquisition date.
c. Recognize and measure the identifiable assets acquired and the liabilities assumed.
d. Recognize and measure either goodwill acquired or a contribution received.

Identifying an Acquirer

9. An acquirer shall be identified for all mergers and acquisitions. An acquirer is the organization that obtains control of an acquiree and recognizes the acquiree in its financial statements. In identifying the acquirer in a merger or acquisition, all pertinent facts and circumstances shall be considered.

10. The guidance[4] in SOP 94-3 and the health care Guide for determining whether an organization obtains control of an entity shall be used to identify the acquirer. If an acquirer cannot be determined based solely on that guidance, the guidance in paragraph 11 of this Statement shall be used to determine which organization is the acquirer.

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[3]In practice, some not-for-profit organizations use the term *joint venture* to refer to a partially owned subsidiary that is controlled by the not-for-profit organization. However, the use of the term joint venture in this Statement is consistent with the description in paragraph 3(d) of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock,* of a corporate joint venture. That guidance states that "an entity which is a subsidiary of one of the 'joint venturers' is not a . . . joint venture." Therefore, the scope of this Statement includes joint ventures that are initially consolidated into the financial statements of a not-for-profit organization.

[4]FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* generally excludes not-for-profit organizations. However, that Interpretation applies to a not-for-profit organization that is used by a business entity in a manner similar to a variable interest entity in an effort to circumvent the provisions of that Interpretation. In that circumstance, the primary beneficiary (determined in accordance with Interpretation 46(R)) of a variable interest entity is always the acquirer.

11. All pertinent facts and circumstances shall be considered in determining which organization is the acquirer, including the following factors:

a. **The transfer of consideration.** In a merger or acquisition effected solely by transferring cash or other assets or by incurring liabilities, the entity that transfers the cash or other assets or incurs the liabilities is likely to be the acquirer.

b. **The process used to select the governing body of the resulting organization.** All else being equal, the acquirer is the entity whose governing body has the ability to select or dominate the process of selecting the governing body of the resulting organization. That ability may be demonstrated by an entity's powers to elect or appoint members to the resulting organization's governing body or an entity's powers to dominate the process of selecting a voting majority. In determining whether one of the entities has the power to dominate the selection process, consideration shall be given to the existence of rights to elect or appoint members to the governing body that are provided by the resulting organization's articles of incorporation, by its bylaws, or by provisions in the merger or acquisition agreement. Consideration also shall be given to the ability of one entity to dominate the selection process through other means. Paragraph A8 provides factors to consider in assessing which entity is able to dominate the governing body.

c. **The relative size of the entities.** The acquirer is commonly the larger entity in a merger or acquisition. For example, the entity that has significantly greater assets, revenues, expenditures, number of employees, or total entity fair values (if known) is likely to be the acquirer.

d. **The process for selecting the management team of the resulting organization.** All else being equal, if one of the combining entities can select or dominate the process of selecting the management team of the resulting organization, that entity is likely to be the acquirer.

e. **The mission and name of the resulting organization.** In a merger or acquisition, the resulting organization often retains the mission and the legal name of the acquirer.

f. **The entity that initiated the transaction.** In a merger or acquisition involving more than two entities, the entity that initiates the transaction is likely to be the acquirer; however, the facts and circumstances surrounding a merger or acquisition sometimes indicate that an acquiree initiates the transaction.

12. If a new not-for-profit organization is formed to effect a merger or acquisition by a not-for-profit organization, one of the entities that existed before the merger or acquisition shall be identified as the acquirer based on available evidence. The guidance in paragraphs 9–11 shall be used to identify an acquirer.

Determining the Acquisition Date

13. The acquisition date is the date an acquirer obtains control of an acquiree. On that date, the acquirer shall recognize the assets acquired and liabilities assumed that compose the acquiree in its financial statements.

14. The closing date or the date the merger or acquisition is finalized in law often is the same as the date an acquirer obtains control of an acquiree. However, in some cases, the acquisition date may precede the closing date or the date the merger or acquisition is finalized in law. For example, a written agreement may provide an acquirer with control of an acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances surrounding a merger or acquisition in assessing when it obtains control of an acquiree.

Recognizing and Measuring the Identifiable Assets Acquired and the Liabilities Assumed

Recognition Requirements

15. Except as provided in paragraphs 25–29, an acquirer shall recognize separately from goodwill the identifiable assets acquired and liabilities assumed that compose an acquiree. An acquirer shall use the guidance in FASB Concepts Statement No. 6, *Elements of Financial Statements,* to determine whether the items acquired or assumed meet the definitions of assets and liabilities. Additional guidance for determining whether those assets and liabilities are part of an acquiree or are part of another transaction is provided in paragraphs 58–60.

16. The recognition requirements of this Statement often will result in an acquirer recognizing assets and liabilities that had not been reflected in the preacquisition financial statements of the acquiree. Examples of those assets are identifiable intangible assets, contingencies that meet the definition of assets or liabilities, and assets to be used in research and development.

Intangible assets

17. Many intangible assets acquired in a merger or acquisition may have been internally developed by the acquiree and, therefore, were not recognized as assets in its preacquisition financial statements. An example of such an intangible asset is a donor list or relationship. In a merger or acquisition, an intangible asset is identifiable if it arises from contractual or other legal rights (the contractual-legal criterion) or is separable (separability criterion). Intangible assets that meet the contractual-legal criterion are identifiable even if the asset is not transferable or separable from an acquiree or from other rights and obligations. Paragraphs A9–A41 provide guidance for identifying acquired intangible assets that generally meet the recognition provisions of this Statement.

Contingencies that meet the definition of assets or liabilities

18. An acquirer shall recognize an asset or liability arising from contingencies acquired or assumed in a merger or acquisition if that asset or liability meets the definition of an asset or a liability in Concepts Statement 6. That asset or liability may not have been recognized in the preacquisition financial statements of the acquiree because the recognition criteria in Statement 5 were not met.

19. After initial recognition, that asset or liability shall be accounted for as follows:

a. An asset or liability that would be accounted for in accordance with Statement 5 if it was acquired or incurred in an event other than a merger or acquisition shall continue to be measured at fair value with any changes in fair value recognized in changes in net assets in each reporting period.
b. All other assets or liabilities shall be accounted for in accordance with generally accepted accounting principles (GAAP), such as FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

Assets to be used in research and development

20. An acquirer shall recognize all acquired identifiable intangible and tangible assets that are used in research and development activities regardless of whether there are alternative future uses for those assets. After initial recognition, the acquirer shall apply the provisions of FASB Statement No. 142, *Goodwill and Other Intangible Assets,* and FASB Statement No. 2, *Accounting for Research and Development Costs,* as amended by paragraph E2 of this Statement.[5]

Additional guidance for recognizing particular assets acquired and liabilities assumed

21. Additional guidance for identifying assets and liabilities that meet the recognition criteria in this Statement follows.

Recognition of assets and liabilities arising from acquired leases

22. Except for operating leases in which the acquiree is the lessee,[6] an acquirer shall recognize separately the asset and liability embodied in a lease. For example, if the acquiree is the lessor to a lease that is classified as an operating lease, the acquirer shall recognize the asset subject to the operating lease separately from any related liability embodied in a lease. After initial recognition, assets and liabilities related to leases shall be accounted for in accordance with GAAP.

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[5]Those amendments supersede FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, which required research and development assets acquired in a business combination that have no alternative future uses to be measured at their fair values and expensed at the acquisition date.

[6]See paragraph 28 for guidance on acquired operating leases for which the acquiree is the lessee.

Determining the classification of an acquired lease

23. In accordance with FASB Statement No. 13, *Accounting for Leases,* as interpreted by FASB Interpretation No. 21, *Accounting for Leases in a Business Combination,* as amended, a lease of the acquiree (regardless of whether the acquiree is the lessee or lessor) retains the lease classification determined by the acquiree at the lease inception unless the provisions of a lease are modified as a result of the merger or acquisition in a way that would require the acquirer to consider the revised agreement a new lease agreement. In that circumstance, the acquirer would classify the new lease according to the criteria set forth in Statement 13 based on the terms of the modified lease.

Liabilities associated with restructuring or exit activities

24. An acquirer shall recognize assumed liabilities for costs associated with restructuring or exit activities in a merger or acquisition that meet the recognition criteria in FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* as of the acquisition date. Under that Statement, a liability for a cost associated with an exit or disposal activity is incurred when the definition of a liability[7] in Concepts Statement 6 is met. Costs associated with restructuring or exit activities that do not meet the recognition criteria in Statement 146 as of the acquisition date are recognized separately from the merger or acquisition, generally as postcombination expenses of the organization when incurred. An acquirer might expect to incur future costs associated with any of the following actions:

a. Exiting an activity of an acquiree
b. Involuntarily terminating the employment of an acquiree's employees
c. Relocating an acquiree's employees.

Those costs are not assumed liabilities of the acquiree and are not accounted for as part of the merger or acquisition.

Exceptions to the Recognition Requirements

Collections

25. An acquirer shall not apply this Statement's recognition requirements to a collection item that it acquires as part of a merger or acquisition if the acquirer has an organizational policy not to capitalize collection items in accordance with Statement 116. Rather, consistent with Statement 116, an acquirer shall:

a. Not recognize a collection item as an asset.
b. Recognize the cost of the purchased collection items as a decrease in the appropriate class of net assets in the statement of activities. Paragraphs A42–

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[7]Paragraphs 8–17 of Statement 146 provide additional guidance for applying the recognition and measurement provisions of that Statement to certain costs that often are associated with an exit or disposal activity.

A48 provide guidance on determining whether the collection item is purchased or contributed in a merger or acquisition.

26. An acquirer that capitalizes its collections shall recognize the acquisition date fair value of contributions or purchases of a work of art, historical treasure, or similar assets as an acquired asset.

Conditional promises to give

27. An acquirer shall not apply this Statement's recognition requirements to conditional promises to give that it acquires or assumes as part of the merger or acquisition. Rather, an acquirer shall apply the guidance in Statement 116 to account for those conditional promises. Consistent with Statement 116, an acquirer shall:

a. Recognize a conditional promise **only** if the conditions on which it depends are substantially met as of the acquisition date.
b. Recognize a transfer of assets with a conditional promise to contribute them as a refundable advance unless the conditions have been substantially met as of the acquisition date.

Operating leases

28. If an acquiree is the lessee to an operating lease, the acquirer shall not recognize separately the asset and related liability embodied in the lease. However, the acquirer shall assess whether each of an acquiree's operating leases is at market terms as of the acquisition date regardless of whether the acquiree is the lessee or lessor. If an operating lease is not at market terms as of the acquisition date, an acquirer shall recognize:

a. An intangible asset if the contractual terms of the operating lease are favorable relative to market terms
b. A liability if the contractual terms of the operating lease are unfavorable relative to market terms.

After initial recognition, an intangible asset or liability related to the favorable or unfavorable terms of an operating lease shall be accounted for in accordance with GAAP, including Statement 142 for intangible assets and Interpretation 21 for liabilities with unfavorable terms.

Assembled workforce

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

Measurement Requirements

30. An acquirer shall measure the identifiable assets acquired and liabilities assumed at their fair values on the acquisition date except as provided in paragraphs 34–36.

31. One of the assets acquired in a merger or acquisition may be a financial asset such as a loan or other receivable for which the acquiree had provided an allowance for uncollectible amounts. Because an acquirer is required to measure an acquired asset at fair value, any uncertainty about the collectibility of future cash flows would be reflected in the acquirer's fair value measurement of the receivable. Therefore, an acquirer shall not recognize a separate valuation allowance at the acquisition date. Subsequent changes to those receivables shall be accounted for in accordance with GAAP.

32. An organization may also acquire or assume contributions, including unconditional promises to give and contributions of split-interest agreements. The assets or liabilities related to those contributions may not have been measured at fair value in the preacquisition financial statements of the acquiree because GAAP preclude the revision of the discount rate subsequent to the initial recognition of a contribution unless the measurement objective for periods subsequent to the period of initial recognition is fair value. A merger or acquisition is an event that requires fair value measurement; therefore, an acquirer shall measure those assets and liabilities at their acquisition date fair value.

33. If an organization is unable to measure the fair value of an asset acquired or liability assumed at the acquisition date, the measurement period guidance in paragraphs 52–57 applies. If any of those measurements can be determined only provisionally at the end of the reporting period in which the merger or acquisition occurs, an acquirer shall report those provisional amounts in its financial statements.

Exceptions to the Fair Value Measurement Requirements

Assets held for sale

34. An acquirer shall measure an acquired long-lived asset (or disposal group) that is classified as held for sale as of the acquisition date at fair value less cost to sell. Further guidance in applying that requirement is included in paragraphs 30–32 and 34 and 35 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*

Deferred taxes

35. An acquirer shall measure any deferred tax asset or liability in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, as amended. Paragraphs A49 and A50 include guidance for applying those requirements for measuring and recognizing deferred tax assets (including valuation allowances) and liabilities.

Employee benefit plans

36. An acquirer shall measure any asset or liability related to an acquiree's employee benefit plans that is within the scope of FASB Statement No. 87, *Employers' Accounting for Pensions,* as amended, or No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* as amended, in accordance with paragraph 74 of Statement 87 or paragraphs 86–88 of Statement 106.

Recognizing and Measuring either Goodwill Acquired or a Contribution Received

37. An acquirer shall recognize either goodwill of an acquiree or the contribution inherent in a merger or acquisition, depending on the fair value of the identifiable assets compared with the fair value of the liabilities assumed and the consideration transferred for the acquiree (if any). Paragraphs 38–46 provide guidance for determining the fair value of the consideration transferred. Paragraphs 47–50 provide guidance for the recognition and measurement of goodwill of the acquiree or the contribution inherent in the merger or acquisition.

Measuring the Consideration Transferred

38. An acquirer shall measure the fair value of the consideration transferred in exchange for an acquiree, if any, as of the acquisition date.

39. The fair value of the consideration transferred in exchange for an acquiree is the sum of the acquisition date fair values of the assets transferred by the acquirer and liabilities assumed or incurred by the acquirer. Examples of the consideration transferred include cash, other assets, and contingent consideration (see paragraphs 44 and 45). The consideration transferred in exchange for the acquiree can be transferred to the former parent of the acquiree, transferred to a designee of the former parent, or transferred to or from an unrelated third-party donor (paragraphs A66 and A67 provide an example of assistance received from a third-party donor).

40. The consideration transferred may include assets or liabilities of the acquirer that has carrying amounts that differ from their fair values at the acquisition date (for example, nonmonetary assets). In that case, the acquirer shall remeasure those transferred assets or liabilities at their fair values as of the acquisition date and recognize any gains or losses in its statement of activities. However, if those assets or liabilities are transferred to the acquiree and, therefore, remain within the resulting organization after the merger or acquisition, the acquirer shall eliminate any gains or losses on those transferred assets or liabilities in the consolidated financial statements.[8]

41. An asset transferred by the acquirer to an unrelated third-party donee (or a liability incurred) as a required condition of a merger or acquisition shall be accounted for as consideration transferred for the acquiree unless control over the future economic benefits of those transferred assets is retained by the acquirer. An acquirer that retains control over the future economic benefits of the transferred assets shall account for that transfer as an asset-for-asset exchange. Examples of asset transfers in which control over the future economic benefits of the transferred assets is retained by the acquirer include the following:

a. The assets are transferred to a recipient that is controlled by the acquirer. By virtue of its control over the recipient, the acquiring organization has the

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[8]Paragraph 3 states that this Statement does not apply to a transfer of net assets or exchange of equity interests between entities under common control. Guidance for those transactions is included in paragraphs A94–A100.

ability to revoke the transfer or direct the use of the assets to itself or an affiliate.

b. The asset transfer is otherwise revocable, repayable, or refundable.

c. The assets are transferred with the stipulation that they be used on behalf of, or for the benefit of, the acquiree, the acquirer, the consolidated organization, or their affiliates. Paragraphs A51–A53 provide an illustration of an asset transfer in which control over the future economic benefits is retained by the acquirer after the merger or acquisition.

42. If the information necessary to measure the fair value of some or all of the consideration transferred is not available at the acquisition date, the measurement period guidance in paragraphs 52–57 applies. If any of those measurements can be determined only provisionally at the end of the reporting period in which the merger or acquisition occurs, an acquirer shall report those provisional amounts in its financial statements.

43. An acquirer shall assess whether any portion of the consideration transferred includes payments or other arrangements that are not consideration transferred for the acquiree. Paragraphs 58–60 provide guidance for making that assessment. Only the consideration transferred as part of the merger or acquisition shall be accounted for as part of the acquisition accounting.

Contingent consideration

44. As described in paragraph 39, the fair value of the consideration transferred includes the acquisition date fair value of any obligations of an acquirer to transfer additional assets (or equity interests) if specified future events occur or conditions are met (commonly called contingent consideration). For example, an acquirer may agree to transfer additional cash or other assets to the former owners of the acquiree or another beneficiary after the acquisition date if the acquiree meets specified financial or nonfinancial targets in the future. An acquirer shall recognize and measure the fair value of that contingent consideration as of the acquisition date and shall classify that obligation as either a liability or equity (net assets) on the basis of other GAAP.

45. After initial recognition, an acquirer shall account for changes in the fair value of contingent consideration that do not qualify as measurement period adjustments (see paragraphs 52–57) as follows:

a. Contingent consideration classified as liabilities shall be measured at fair value with changes in the fair value recognized in changes in net assets in each reporting period.

b. Contingent consideration classified as equity (net assets)[9] shall not be remeasured.

[9]For example, a not-for-profit organization agrees to issue a fixed number of shares of the common stock of its for-profit subsidiary as consideration transferred for the acquiree.

Costs incurred in connection with a merger or acquisition

46. An acquirer shall not include costs incurred in connection with a merger or acquisition in the measure of the fair value of the consideration transferred or the assets acquired or liabilities assumed as part of the merger or acquisition. An acquirer shall account for such costs separately from the merger or acquisition in accordance with GAAP. Such costs include finder's fees; advisory, legal, accounting, valuation, other professional or consulting fees; general administrative costs; and costs of registering and issuing debt securities. Those costs should be expensed, with the exception of certain costs incurred for issuing debt or equity instruments used to effect a merger or acquisition.

Goodwill

47. An acquirer shall recognize goodwill of an acquired business or nonprofit activity to the extent that the acquisition date values of the consideration transferred, if any, and liabilities assumed exceed the acquisition date values of the identifiable assets acquired (determined in accordance with the requirements of this Statement). The acquisition date values refer to the amounts assigned to recognized assets and liabilities as required by this Statement, which, with limited exceptions, is fair value at the acquisition date. For example, an acquirer that transferred cash of $10,000 and assumed liabilities with an acquisition date value of $97,000 in exchange for identifiable assets with an acquisition date value of $100,000 would recognize goodwill of $7,000. The acquirer would not need to transfer cash or other assets as consideration to recognize goodwill. For example, an acquirer that assumes liabilities with an acquisition date value of $108,000 in exchange for identifiable assets with an acquisition date value of $100,000 would recognize goodwill in the amount of $8,000.

48. Because goodwill is measured as a residual, the amount recognized as goodwill may include (a) synergies and other benefits that are expected from consolidating the activities of the acquirer and the acquiree, (b) intangible assets that do not meet the criteria in paragraph 17 for recognition separately from goodwill, (c) assets that are exempt from recognition in accordance with paragraphs 25–29, and (d) any difference between the fair values of the assets acquired and liabilities assumed and the amounts recognized in accordance with paragraphs 34–36.

Contribution Received

49. An acquirer shall recognize a contribution received, if any, as revenue or gain in the period of the merger or acquisition. That requirement applies regardless of whether the acquiree is a business or a nonprofit activity. For example, if a business or nonprofit activity is voluntarily transferred to a not-for-profit organization for no consideration or in exchange for assets of substantially lower value and no unstated rights or privileges are involved, the acquirer is required to recognize the contribution received inherent in that transaction.

50. An acquirer shall measure the contribution received in a merger or acquisition as the excess of the acquisition date values of the identifiable assets acquired (including

purchased collection items) over the sum of the acquisition date values of the consideration transferred and liabilities assumed. For example, an acquirer that merged with another entity and recognized identifiable assets with an acquisition date value of $50,000 and assumed liabilities with an acquisition date value of $45,000 would recognize a $5,000 contribution received. The acquirer might recognize a contribution received in a merger or acquisition in which the acquirer transfers cash or other assets as consideration. For example, if identifiable assets with an acquisition date value of $150,000 were acquired in exchange for cash consideration of $10,000 and the assumption of liabilities with an acquisition date value of $100,000, the acquirer would recognize a $40,000 contribution received.

Additional Guidance for Applying the Acquisition Method

51. Sometimes an organization acquires less than 100 percent of the equity ownership interests of a business, or it acquires a business in steps. Paragraphs A74 and A75 provide guidance for applying the acquisition method to those types of acquisitions.

Measurement Period

52. The measurement period is the period after the acquisition date during which an acquirer may adjust the provisional amounts recognized at the acquisition date in accounting for a merger or acquisition. The measurement period provides an acquirer a reasonable amount of time to obtain the information necessary to identify and measure the following:

a. The acquisition date fair value of the consideration transferred for an acquiree
b. The acquisition date values of the identifiable assets acquired, liabilities assumed, and goodwill or inherent contributions received that are recognized in accordance with the requirements of this Statement.

53. During the measurement period, an acquirer shall adjust the provisional amounts recognized at the acquisition date to reflect any new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, an acquirer also shall recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date.

54. The measurement period ends as soon as an acquirer receives the necessary information about facts and circumstances that existed as of the acquisition date or learns the information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

55. Generally, adjustments to the provisional amounts recognized for identifiable assets and liabilities during the measurement period are recognized through an offsetting adjustment to goodwill or contributions received. For example, assume that a not-for-

profit organization acquires a business or nonprofit activity—no consideration is transferred, and the identifiable assets acquired, including an intangible asset, exceed the value of the liabilities assumed. Also assume that during the measurement period the acquirer obtains new information about the fair value of that intangible asset as of the acquisition date. In that case, the adjustment to the provisional amount recognized for that asset may be offset by a corresponding adjustment to the provisional amount recognized for the contribution received. However, the offsetting adjustment (or part of the offsetting adjustment) may be to an asset or liability other than goodwill or contributions received, such as the provisional amount recognized for a directly related contingent consideration liability.

56. An acquirer shall recognize any adjustments to the provisional values during the measurement period as if the accounting for the merger or acquisition had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements shall be adjusted, including any change in depreciation, amortization, or other effects recognized as a result of completing the initial accounting. Paragraphs A54–A62 provide additional guidance and illustrative examples for applying the measurement period requirements.

57. After the end of the measurement period, the accounting for a merger or acquisition shall be restated only to correct an error. In those circumstances, an acquirer should apply the guidance in FASB Statement No. 154, *Accounting Changes and Error Corrections.*

Assessing What Is Part of the Merger or Acquisition

58. An acquirer shall assess whether any portion of the consideration transferred (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the merger or acquisition. Only the consideration transferred for an acquiree and the assets acquired or liabilities assumed or incurred that are part of the merger or acquisition shall be included in the acquisition accounting. Any portion of the consideration transferred or any assets acquired or liabilities assumed or incurred that are not part of the merger or acquisition shall be accounted for separately.

59. Judgment is required to determine whether a portion of the consideration transferred, or the assets acquired and liabilities assumed or incurred, are part of the merger or acquisition. A transaction or event arranged primarily for the economic benefit of an acquirer or a consolidated entity is not part of the merger or acquisition and shall be accounted for separately from the acquisition accounting. A transaction or event arranged primarily for the benefit of an acquiree or its former owners generally is part of the merger or acquisition and is included in the acquisition accounting. An acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction or event is arranged primarily for the economic benefit of the acquirer or resulting combined organization, rather than for the acquiree or its former owners.

a. The reasons for the transaction or event
b. The individual who initiated the transaction or event

c. The timing of the transaction or event.

60. Examples of payments or other arrangements that are not part of the merger or acquisition include:

a. Payments that effectively settle preexisting relationships between an acquirer and an acquiree (see paragraphs A71–A73)
b. Payments to compensate employees or former owners of an acquiree for future services (see paragraphs A68–A70)
c. Payments to reimburse an acquiree or its former owners for paying an acquirer's costs incurred in connection with the merger or acquisition
d. Payments by a former owner of a business that are unrelated and separable from the acquiree, such as a contribution to an acquirer or its affiliates to fund activities unrelated to those of an acquiree. Those contributions made should be accounted for in accordance with Statement 116.

Paragraphs A63–A73 provide guidance for assessing whether a portion of the consideration transferred and any assets acquired and liabilities assumed are not part of the merger or acquisition.

Presentation

Statement of Activities

61. An acquirer shall present contributions recognized in a merger or acquisition as a line item separate from other contributions in the statement of activities and shall classify the recognized contributions received based on the type of restrictions imposed on the net assets. In classifying those assets, an acquirer shall:

a. Include restrictions imposed on the net assets of the acquiree by a donor prior to a merger or acquisition and those imposed by the donor of the business or nonprofit activity acquired, if any, in accordance with paragraph 14 of Statement 116.
b. Report donor-restricted contributions as restricted, not as unrestricted support, regardless of whether the restrictions are met in the same reporting period in which the merger or acquisition occurs. That is, the acquirer shall not apply the reporting exception in paragraph 14 of Statement 116 to restricted net assets acquired in a merger or acquisition.

Thus, the contributions may increase any one or more of the following: permanently restricted net assets, temporarily restricted net assets, or unrestricted net assets. Additionally, if an acquirer is within the scope of the health care Guide, the recognized contributions received shall be presented separately from the performance indicator unless the acquired business or nonprofit activity meets the criteria in paragraph 32 of Statement 144 to be classified as held for sale.

62. An acquirer that transfers assets as consideration in a merger or acquisition and acquires net assets shall assess whether that transaction results in a change in the net asset classifications of the resulting organization:

a. An acquirer may include restrictions on its net assets that expire as a result of transferring consideration in a merger or acquisition with other expirations of donor-imposed restrictions or may separately report those expirations during the period in which the merger or acquisition occurs. For example, an acquiring organization might satisfy a restriction imposed on its resources prior to the merger or acquisition by the payment of consideration.
b. An acquirer shall report other changes to the net asset classification of the resulting organization separate from any other reclassifications and separate from any expiration of those restrictions during the period in which the merger or acquisition occurs. For example, an acquirer that transfers as consideration its unrestricted assets and acquires assets from the acquiree that have permanent or temporary donor restrictions should recognize a reclassification in its statement of activities.

Statement of Cash Flows

63. An acquirer shall present the following cash inflows and outflows and noncash items related to a merger or acquisition in the statement of cash flows:

a. The entire portion of any net cash flow from a merger or acquisition (cash paid as consideration, if any, less cash of the acquiree that is acquired) shall be reported as an investing activity.
b. Noncash contributions received shall be reported in related disclosures as a noncash activity in accordance with paragraph 32 of FASB Statement No. 95, *Statement of Cash Flows.*

Paragraphs A80–A82 provide an illustration of those requirements.

Disclosures

Nature and Financial Effect of Mergers and Acquisitions

64. An acquirer shall separately disclose information that enables users of its financial statements to evaluate the nature and financial effect of mergers and acquisitions whose acquisition date is:

a. During the reporting period
b. After the balance sheet date but before the financial statements are issued, unless impracticable (see paragraph 66(b)).

65. To meet the objective in paragraph 64, an acquirer shall separately disclose the following information, to the extent applicable, for each material merger or acquisition that occurs during the reporting period:

a. The name and a description of the acquiree.
b. The acquisition date.
c. The percentage of the ownership interest acquired, such as voting equity instruments (if applicable).
d. The primary reasons for the merger or acquisition, including a description of the factors that resulted in the recognition of goodwill, if any, such as expected cost-savings, improved efficiency, and enhanced services.
e. The acquisition date fair value of the consideration transferred (or if no consideration was transferred, that fact), including the fair value of each major class of consideration, such as:
   (1) Cash
   (2) Other tangible or intangible assets, including a for-profit business or subsidiary of the acquirer
   (3) Contingent consideration
   (4) Debt instruments.
f. The amounts recognized as of the acquisition date for each major class of assets acquired and liabilities assumed in the form of a condensed balance sheet.
g. The maximum potential amount of future payments (undiscounted) the acquirer could be required to make under the terms of the acquisition agreement. If there is no limitation on the maximum potential amount of future payments, that fact shall be disclosed.
h. The amount of collection items acquired in a merger or acquisition recognized as a decrease in the acquirer's net assets in the statement of activities, under the permitted noncapitalization policy of Statement 116.
i. The amount of conditional promises made to the acquiree that are acquired in a merger or acquisition and a description and amount for each group of promises that have similar characteristics, such as amounts of promises conditioned on establishing new programs, completing a new building, and raising matching gifts by a specified date.
j. The amount of costs incurred in connection with the merger or acquisition, the amount recognized as an expense, and the line item or items in the statement of activities in which those expenses are recognized.
k. In a merger or acquisition in which the acquirer and acquiree have a preexisting relationship:
   (1) The nature of the preexisting relationship
   (2) The measurement of the settlement amount of the preexisting relationship, if any, and the valuation method used to determine the settlement amount
   (3) The amount of any settlement gain or loss recognized and the line item in the statement of activities in which that gain or loss is recognized.
l. In an acquisition achieved in stages, the acquirer's previously acquired noncontrolling ownership interest in the acquiree, the amount of any gain or loss recognized in accordance with paragraph A75, and the line item in the statement of activities in which that gain or loss is recognized.

66. An acquirer also shall separately disclose the information required by:

a. Paragraphs 65(e)–65(k) in the aggregate for individually immaterial mergers and acquisitions that collectively are material
b. Paragraph 65 if a material merger or acquisition is completed after the balance sheet date but before the financial statements are issued unless disclosure of any of the information is impracticable. *Impracticable* is used with the same meaning as *impracticability* in paragraph 11 of Statement 154. If disclosure of any of the information required by paragraph 65 is impracticable, that fact and the reasons why it is impracticable shall be disclosed.

Public Entity Disclosures

67. An acquirer that is a public entity (as defined in paragraph 4) also shall disclose the following information for each material merger or acquisition that occurs during the reporting period. An acquirer that is a public entity shall disclose the same information in the aggregate for individually immaterial mergers and acquisitions that are collectively material and occur during the reporting period. If disclosure of any of the information required by this paragraph is impracticable, that fact and the reasons why it is impracticable shall be disclosed.

a. The amount of revenue of the acquiree since the acquisition date included in the statement of activities for the reporting period.
b. For an acquiree that is a not-for-profit organization, the amount of changes in unrestricted net assets, changes in temporarily restricted net assets, and changes in permanently restricted net assets since the acquisition date included in the statement of activities of the reporting period.
c. For an acquiree that is a for-profit entity, the amount of income before extraordinary items and the cumulative effect of accounting changes, net income, and earnings per share (if applicable) of the reporting period since the acquisition date.
d. The following supplemental pro forma information:
    (1) The changes in unrestricted net assets, changes in temporarily restricted net assets, and changes in permanently restricted net assets of the organization for the current reporting period as though the acquisition date for all mergers and acquisitions that occurred during the current year had been as of the beginning of the annual reporting period.
    (2) If comparative financial statements are presented, the changes in unrestricted net assets, changes in temporarily restricted net assets, and changes in permanently restricted net assets of the organization for the comparable prior reporting period as though the acquisition date for all mergers and acquisitions that occurred during the current year had been as of the beginning of the comparable prior annual reporting period.

68. In determining the pro forma amounts, to the extent applicable, income taxes, interest expense, preferred share dividends, and depreciation and amortization of assets shall be adjusted to the accounting base recognized for each in recording the merger or acquisition. Pro forma information related to changes in net assets (or income) of periods prior to the merger or acquisition shall be limited to the changes in net assets (or income) for the immediately preceding period. An acquirer also shall disclose the nature and amount of any material, nonrecurring items included in the reported pro forma changes in net assets.

Adjustments Recognized in the Current Reporting Period Relating to Mergers and Acquisitions

69. An acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period relating to mergers and acquisitions of current or previous reporting periods.

70. To meet the objective in paragraph 69, an acquirer shall disclose the following information for each material merger or acquisition or in the aggregate for individually immaterial mergers and acquisitions that are collectively material:

a. If the amounts recognized in the financial statements for the merger or acquisition have been determined only provisionally:
    (1) The reasons why the initial accounting for the merger or acquisition is not complete
    (2) The assets acquired or the liabilities assumed for which the measurement period is still open
    (3) The nature and amount of any measurement period adjustments recognized during the reporting period.
b. A reconciliation of the beginning and ending balances of liabilities for contingent consideration and contingencies that are required to be remeasured to fair value after initial recognition in accordance with paragraphs 19 and 45, showing separately the changes in fair value during the reporting period and amounts paid or otherwise settled.
c. If an acquirer is subject to taxes on portions of its income, a description of the discrete event or circumstance that occurred after the acquisition date that resulted in deferred tax assets acquired as part of the acquisition being recognized as income within 12 months after the acquisition date (see paragraph 79).

Changes in the Carrying Amount of Goodwill

71. An acquirer shall disclose information that enables users of its financial statements to evaluate changes in the carrying amount of goodwill during the reporting period.

72. To meet the objective in paragraph 71, if the total amount of goodwill is significant, an acquirer shall disclose the following information for each material merger or acquisition that occurs during the reporting period: the total amount of goodwill and, if the

reporting units to which goodwill is allocated are subject to income taxes, the amount that is expected to be deductible for tax purposes.

73. An acquirer also shall disclose the information required by paragraph 72:

a. In the aggregate for individually immaterial mergers and acquisitions that are collectively material
b. If a material merger or acquisition is completed after the balance sheet date but before the financial statements are issued, unless such disclosure is impracticable. If disclosure of any of the information required by paragraph 72 is impracticable, that fact and the reasons why it is impracticable shall be disclosed.

74. An acquirer shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period as required by Statement 142, as amended by the Statement on not-for-profit organizations' goodwill.

Additional Information to Meet Objectives

75. If the specific disclosures required by this and other Statements do not meet the objectives set out in paragraphs 64, 69, or 71, an acquirer shall disclose any additional information necessary to meet those objectives.

Effective Date and Transition

76. This Statement shall apply prospectively to mergers and acquisitions for which the acquisition date is on or after the beginning of the first annual period beginning on or after [date to be inserted after exposure]. Earlier application is encouraged. However, this Statement shall be applied only at the beginning of an annual period that begins on or after this Statement is issued. If this Statement is applied before the effective date, that fact shall be disclosed. This Statement shall be adopted concurrently with the proposed Statement on consolidated financial statements, including accounting and reporting of noncontrolling interests in subsidiaries, as amended by this Statement.

77. Except as provided in paragraph 79 and in the transition provisions of the proposed Statement on not-for-profit organizations' goodwill, assets and liabilities that arose from mergers and acquisitions whose acquisition dates preceded the application of this Statement shall not be adjusted upon application of this Statement.

78. An entity that has not applied Statement 142 in its entirety shall apply that Statement, as amended by the Statement on not-for-profit organizations' goodwill, at the same time that it applies this Statement.

79. For acquisitions of businesses or nonprofit activities in which an acquirer is subject to taxes on portions of its income and the acquisition date precedes the date this Statement is applied, the acquirer shall:

a. Apply the requirements of Statement 109, as amended by paragraph E2, prospectively. Therefore, the acquirer shall not adjust the accounting for prior mergers and acquisitions for the subsequent recognition of acquired deferred tax benefits (that is, by elimination of that valuation allowance) unless the rebuttable presumption in paragraph 30 of Statement 109, as amended by this Statement, applies in the current period.

b. Recognize, as a reduction to income tax expense (or as a credit to contributed capital in accordance with paragraph 26 of Statement 109), tax benefits that are recognized more than one year after the acquisition date (that is, by elimination of that valuation allowance).

The provisions of this Statement need not be applied to immaterial items.

Appendix A

IMPLEMENTATION GUIDANCE

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Appendix A

IMPLEMENTATION GUIDANCE

Introduction

A1. This appendix discusses generalized situations and provides examples that incorporate simplified assumptions to illustrate how to apply some of the provisions of this Statement. Application of this Statement's provisions to actual situations will require the exercise of judgment; this appendix is intended to aid in making those judgments.

Definition of a Business and a Nonprofit Activity (Application of Paragraph 4(d) and 4(p))

A2. A *business* and a *nonprofit activity* are defined as integrated sets of activities and assets that are capable of being conducted and managed for the purpose of providing benefits. In the case of a business, those benefits are economic benefits that are provided as a return to investors (either reflected in the market price of the equity or through dividends) or other forms, such as lower costs that are provided directly and proportionately to owners, members, or participants. In the case of a nonprofit activity, those benefits are other than goods or services provided at a profit or profit equivalent and are provided as a fulfillment of the purpose or mission for which an organization exists (for example, goods or services to beneficiaries, customers, or members) (paragraph 4(d) and 4(p)). A business or nonprofit activity consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses or nonprofit activities usually have outputs, outputs are not required for an integrated set to qualify as a business or nonprofit activity. The three elements of a business or nonprofit activity are defined as follows:

a. *Input*—Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include long-lived assets (including intangible assets or rights to use long-lived assets), intellectual property, ability to obtain access to necessary materials or rights, and employees.
b. *Process*—Any system, standard, protocol, convention, or rule that when applied to an input or inputs creates or has the ability to create outputs. Examples include strategic management processes, operational processes, and resource management processes. Those processes typically are documented; however, an organized workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll, and other administrative systems typically are not processes that are used to create outputs.)
c. *Output*—The result of inputs and processes applied to those inputs that provide or have the ability to provide a return to investors; dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or

participants; or goods or services to beneficiaries, customers, or members that fulfill the purpose or mission for which a not-for-profit organization exists.

A3. To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs—that together are or will be used to create outputs. However, a business or nonprofit activity need not include all of the inputs or processes that the seller used in operating that business or nonprofit activity if a willing party is capable of acquiring the business or nonprofit activity and continuing to produce outputs, for example, by integrating the business or nonprofit activity with its own inputs and processes.

A4. The nature of the elements of a business or nonprofit activity varies by industry and by the structure of an entity's operations (activities), including the entity's stage of development. Established businesses or nonprofit activities often have many, and different, kinds of inputs, processes, and outputs, whereas new businesses or nonprofit activities often have few inputs and processes, and sometimes only a single output (product). Nearly all businesses or nonprofit activities also have liabilities, but a business or nonprofit activity need not have any liabilities.

A5. An integrated set of activities and assets in the development stage may not have outputs. In that case, other factors should be assessed to determine whether the set is a business or nonprofit activity. Those factors would include whether the set:

a. Has begun planned principal activities
b. Has employees, intellectual property, and other inputs and processes that could be applied to those inputs
c. Is pursuing a plan to produce outputs
d. Has the ability to obtain access to customers that will purchase or has the ability to obtain access to beneficiaries, customers, or members that fulfill the purpose or mission for which a not-for-profit organization exists.

A6. The determination of whether a particular set of assets and activities is a business or nonprofit activity should be based on whether the integrated set is capable of being conducted and managed as a business or nonprofit activity by a willing acquirer. Thus, in evaluating whether a particular set is a business or nonprofit activity, it is not relevant whether a seller operated the set as a business or nonprofit activity or whether the acquirer intends to operate the set as a business or nonprofit activity.

A7. If goodwill is present in a particular set of assets and activities, in the absence of evidence to the contrary, the set shall be presumed to be a business or nonprofit activity. However, a business or nonprofit activity need not have goodwill.

Determining the Acquirer: Ability to Select or to Dominate the Process of Selecting the Governing Body (Application of Paragraph 11(b))

A8. In accordance with paragraph 9, the acquirer is the entity that obtains control of the acquiree and recognizes the acquiree in its financial statements. If an acquirer cannot be determined based solely on the existing guidance, paragraph 11 provides a general guide for determining which organization is the acquirer. One of the items within that general guide is an entity's ability to select or to dominate the process of selecting the governing body of the resulting organization. The following factors should be considered in assessing which entity is able to select or to dominate the process of selecting that governing body:

a. If the resulting organization's articles of incorporation or bylaws state that the members of the governing body are appointed, whether one of the entities has the right to appoint a voting majority of the governing body.
b. If the resulting organization governing body is self-perpetuating:
   (1) Whether one of the entities has the right to select a voting majority of the initial governing body of the resulting organization as part of the merger or acquisition agreement
   (2) Whether one of the entities has the ability to dominate the selection of a voting majority of the initial governing body of the resulting organization through means other than negotiated selection rights, such as through disproportionate representation on the committee that selects nominees for that body.
c. If the initial governing body of the resulting organization is selected by the governing members of the combining entities, whether one entity's members have the majority of the voting rights.
d. Any other rights to appoint or designate members of the resulting organization's governing body either as of the acquisition date or in the near future (such as upon the expiration of the terms of some or all of the initial members).
e. If positions on the resulting organization's governing body are designated positions, the effect of those designated positions on the ability of an entity to appoint a voting majority of the resulting organization's governing body.
f. The powers of any sponsoring organizations or members of a not-for-profit corporation and the composition of those sponsors and members. If sponsors and corporate members have limited powers, the effect of those limited powers on the ability of one of the entities to control the resulting organization.
g. If the resulting organization's governing body delegates powers to committees, the nature of those delegated powers and the composition of the committees.
h. The effect of voting requirements (such as supermajority voting requirements) on the ability of one entity to appoint or dominate the selection of a supermajority of the governing body of the resulting organization.

Intangible Assets (Application of Paragraph 17)

Recognition of Intangible Assets Separately from Goodwill

A9. In accordance with paragraph 17, the acquirer recognizes separately from goodwill the acquisition date fair value of intangible assets acquired in a merger or acquisition that are identifiable. An intangible asset is identifiable if it arises from contractual or other legal rights (the contractual-legal criterion) or is separable (separability criterion). Intangible assets that meet the contractual-legal criterion are identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations. For example, an acquiree leases housing space for a shelter under an operating lease with terms that are favorable relative to market prices. The lease terms explicitly prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favorable relative to market prices is an intangible asset that meets the contractual-legal criterion for recognition separately from goodwill, even though the lease contract cannot be sold or otherwise transferred.

A10. The separability criterion means that the acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, asset, or liability. Exchange and contribution transactions provide evidence that an intangible asset is separable from the acquiree and might provide information that can be used to estimate its fair value. An acquired intangible asset meets the separability criterion if there is evidence of exchange or contribution transactions for that type of asset or an asset of a similar type (even if those transactions are infrequent and regardless of whether the acquirer is involved in them). For example, donor, customer, and subscriber lists are frequently licensed or exchanged and, thus, meet the separability criterion. Even if an acquiree believes its donor or customer lists have different characteristics from other donor or customer lists, the fact that donor or customer lists are frequently licensed or exchanged generally means that the acquired donor or customer list meets the separability criterion.

A11. An intangible asset that meets the separability criterion should be recognized separately from goodwill even if the acquirer does not intend to sell, license, or otherwise exchange that asset. The separability criterion is met because the asset is **capable** of being separated from the acquiree or resulting organization and contributed or sold, transferred, licensed, rented, or otherwise exchanged for something else of value.

A12. An intangible asset that is not separable individually meets the separability criterion if it is separable in combination with a related contract, asset, or liability. For example, an acquiree owns a registered trademark, a related secret formula, and unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or consolidated entity and sold if the related trademark is sold, it meets the separability criterion.

A13. An acquirer subsumes into goodwill the value of any acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the potential:

a. Contracts the acquiree is in the process of negotiating with prospective new donors or customers at the acquisition date
b. Gifts the acquiree has not yet received but has solicited from prospective new donors at the acquisition date.

Because those potential contracts and gifts are not identifiable intangible assets at the acquisition date, they are not recognized separately from goodwill. The value of those contracts and gifts should not be reclassified from goodwill for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the acquisition to determine whether a separately recognizable intangible asset existed at the acquisition date.

A14. After initial recognition, intangible assets acquired in a merger or acquisition are accounted for in accordance with the provisions of FASB Statement No. 142, *Goodwill and Other Intangible Assets,* and other applicable generally accepted accounting principles.

A15. The identifiability criterion is used to determine whether an intangible asset should be recognized separately from goodwill. It does not provide guidance for measuring the fair value of an intangible asset. That criterion does not restrict the assumptions used in estimating the fair value of an intangible asset. For example, assumptions that marketplace participants would consider, such as expectations of future contract renewals, are considered in arriving at a fair value measurement even though those renewals do not meet the identifiability criterion. EITF Issue No. 02-7, "Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets," provides guidance for determining whether indefinite-lived intangible assets should be combined into a single unit of accounting for purposes of testing for impairment if they are operated as a single asset and, as such, essentially are inseparable from one another. That guidance also is relevant for determining the unit of accounting when estimating the fair values of intangible assets acquired in a merger or acquisition.

Examples of Intangible Assets That Are Identifiable

A16. The following are examples of identifiable intangible assets acquired in a merger or acquisition. Some of the examples may have characteristics of assets other than intangible assets. Accordingly, those assets should be accounted for on the basis of their substance. These examples are not intended to be all-inclusive.

A17. Intangible assets designated with the symbol # are those that arise from contractual or other legal rights. Those designated with the symbol * do not arise from contractual or other legal rights but are separable. Intangible assets designated with the symbol # might also be separable; however, separability is not a necessary condition for the asset to meet the contractual-legal criterion.

Marketing-Related Intangible Assets

A18. Marketing-related intangible assets are those assets that are primarily used in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

a. Trademarks, trade names, service marks, collective marks, and certification marks #
b. Trade dress (unique color, shape, or package design) #
c. Internet domain names #
e. Noncompetition agreements. #

Trademarks and trade names #

A19. Trademarks are words, names, symbols, or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. Trademarks and trade names may be protected legally through registration with governmental agencies, continuous use in commerce, or by other means. Provided it is protected legally through registration or other means, a trademark or other mark acquired in a merger or acquisition is an intangible asset that meets the contractual-legal criterion. Otherwise, a trademark or other mark acquired in a merger or acquisition can be recognized separately from goodwill provided the separability criterion is met, which would normally be the case.

A20. The terms *brand* and *brand name* are often used as synonyms for trademarks and other marks. However, the former are general marketing terms that are typically used to refer to a group of complementary assets such as a trademark and its related trade name, formulas, recipes, and technological expertise. An entity is not precluded from recognizing, as a single asset apart from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet domain names #

A21. An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in a merger or acquisition meets the contractual-legal criterion.

Donor- and Customer-Related Intangible Assets

A22. Examples of donor- and customer-related intangible assets are:

a. Donor and customer lists*
b. Order or production backlog #

c. Contractual donor and customer relationships #
d. Noncontractual customer relationships. *

Donor and customer lists*

A23. A donor list consists of information about donors, such as their names and contact information. A donor list also may be in the form of a database that includes other information about the donors, such as their donation histories and demographic information. A donor list does not generally arise from contractual or other legal rights. However, donor lists are frequently leased or exchanged. Therefore, a donor list acquired in a merger or acquisition by a not-for-profit organization normally meets the separability criterion. However, a donor list acquired in a merger or acquisition by a not-for-profit organization would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing, or otherwise exchanging information about its donors.

A24. A customer list consists of similar information about customers. Customer lists are also frequently leased or exchanged. Therefore, a customer list acquired in a merger or acquisition normally meets the separability criterion unless the terms of confidentiality or other agreements prohibit an entity from selling, leasing, or otherwise exchanging information about its customers.

Order or production backlog #

A25. An order or production backlog arises from contracts such as purchase or sales orders. An order or production backlog acquired in a merger or acquisition meets the contractual-legal criterion, even if the purchase or sales orders are cancelable.

Contractual donor and customer relationships #

A26. If an entity establishes relationships with its donors or customers through contracts, those relationships generally[10] arise from contractual rights. A written promise to contribute (for example, a completed contribution form), even if cancelable, represents a contractual right. Therefore, generally both the donor and customer contracts and the related relationships acquired in a merger or acquisition meet the contractual-legal criterion. That will be the case even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.

A27. A contract (such as an unconditionally promised contribution (receivable)) and the related donor or customer relationship intangible asset may represent two distinct assets. Both the useful lives and the pattern in which the economic benefits of the two assets are consumed may differ.

A28. 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-

[10]See paragraphs 96–99 of Statement 116 for information about the legal enforceability of promises to give.

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.

A29. Similarly, a customer relationship exists between an entity and its customer if the entity has that information and interaction. Customer relationships meet the contractual-legal criterion when an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the acquisition date. Like donor relationships, customer relationships also may arise through means other than contracts, such as through regular contact by sales or service representatives. As noted in paragraph A25, an order or a production backlog arises from contracts such as purchase or sales orders and, therefore, is also considered a contractual right. Consequently, if an entity has customer relationships with its customers through these types of contracts, the customer relationships also arise from contractual rights and, therefore, meet the contractual-legal criterion.

Example 1: Illustration of a donor relationship intangible asset acquired in an acquisition

A30. NFP-A acquires NFP-B in an acquisition on December 18, 20X6. NFP-B routinely solicits contributions from its donors through contribution forms. As of the acquisition date, NFP-B's donors have not made any promises to give donations to NFP-B. Based on past history, 90 percent of NFP-B's donors are recurring and the remaining 10 percent of the donors have made one-time donations to NFP-B in the past. The potential relationship NFP-B may have with its recurring donors should be assessed to determine whether that relationship meets the contractual-legal criterion and to determine the fair value of the relationship that is separable from goodwill.

A31. As evidenced by completed contribution forms and related recurring contributions received in the past, NFP-B has a practice of establishing successful contracts with 90 percent of its donors. NFP-B's relationships with those donors meet the contractual-legal criterion, even though NFP-B does not have contracts with those donors on December 18, 20X6. In measuring the fair value of the relationships, NFP-B evaluates the expectation for future donations from this group of donors.

Noncontractual customer relationships *

A32. If a customer relationship acquired in a merger or acquisition does not arise from a contract, the relationship may be separable. Exchange transactions for the same asset or a similar asset provide evidence of separability of a noncontractual customer relationship and might also provide information about exchange prices that should be considered when estimating fair value.

Artistic-Related Intangible Assets

A33. Examples of artistic-related intangible assets are:

a. Plays, operas, and ballets #
b. Books, magazines, newspapers, and other literary works #
c. Musical works such as compositions, song lyrics, and advertising jingles #
d. Pictures, photographs #
e. Video and audiovisual material, including motion pictures or films, music videos, and television programs. #

A34. Artistic-related intangible assets acquired in a merger or acquisition meet the identifiability criterion if they arise from contractual or legal rights such as those provided by copyright. Copyrights can be transferred either in whole through assignments or in part through licensing agreements. In determining the fair value of an intangible asset protected by copyright, consideration is given to the existence of any assignments or licenses of the acquired copyrights. An acquirer is not precluded from recognizing a copyright intangible asset and any related assignments or license agreements as a single asset, provided they have similar useful lives.

Contract-Based Intangible Assets

A35. Contract-based intangible assets represent the value of rights that arise from contractual arrangements. Customer contracts are one particular type of contract-based intangible asset. If the terms of a contract give rise to a liability (which might be the case if the terms of an operating lease or customer contract are unfavorable relative to market prices), that liability is recognized as a liability assumed. Examples of contract-based intangible assets are:

a. Licensing, royalty, standstill agreements #
b. Advertising, construction, management, and service or supply contracts #
c. Lease agreements (whether the acquiree is the lessee or lessor) #
d. Construction permits #
e. Franchise agreements #
f. Operating and broadcast rights #
g. Servicing contracts such as mortgage servicing contracts #
h. Employment contracts #
i. Certain use rights such as drilling, water, air, mineral, timber cutting, and route authorities. #

Employment contracts #

A36. Employment contracts that are beneficial contracts from the perspective of the employer are one type of contract-based intangible asset because the pricing of those contracts is favorable relative to market prices.

Technology-Based Intangible Assets

A37. Examples of technology-based intangible assets are:

a. Patented technology #
b. Computer software and mask works #
c. Unpatented technology *
d. Databases *
e. Trade secrets, such as secret formulas, processes, and recipes. #

Computer software and mask works #

A38. If computer software and program formats acquired in a merger or acquisition are protected legally, such as by patent or copyright, they meet the contractual-legal criterion for identification as intangible assets.

A39. Mask works are software permanently stored on a read-only memory chip as a series of stencils or integrated circuitry. Mask works may have legal protection. Mask works with legal protection that are acquired in a merger or acquisition meet the contractual-legal criterion for identification as intangible assets.

Databases *

A40. Databases are collections of information, often stored in electronic form (such as on computer disks or files). A database that includes original works of authorship may be entitled to copyright protection. If a database acquired in a merger or acquisition is protected by copyright, it meets the contractual-legal criterion. However, a database typically includes information created as a consequence of an entity's normal operations, such as customer lists, or specialized information such as scientific data or credit information. Databases that are not protected by copyright can be, and often are, exchanged, licensed, or leased to others in their entirety or in part. Therefore, even if the future economic benefits from a database do not arise from legal rights, a database acquired in a merger or acquisition meets the separability criterion.

Trade secrets such as secret formulas, processes, and recipes #

A41. A trade secret is "information, including a formula, pattern, recipe, compilation, program, device, method, technique, or process that (1) derives independent economic value, actual or potential, from not being generally known and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."[11] If the future economic benefits from a trade secret acquired in a merger or acquisition are legally protected, that asset meets the contractual-legal criterion. Otherwise, trade secrets acquired in a merger or acquisition are identifiable only if the separability criterion is met, which is likely to be the case.

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[11]Melvin, Simensky, and Lanning Bryer, *The New Role of Intellectual Property in Commercial Transaction*s (New York: John Wiley & Sons, 1998), page 293.

Acquired Collections (Application of Paragraph 25)

A42. In accordance with paragraph 25, an acquirer that has an organizational policy not to capitalize collections items should apply FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, in accounting for the acquired collection items. Statement 116 requires that an organization with such a policy not recognize acquired collection items as an asset. That Statement also requires that an organization with such a policy recognize the cost of purchased collection items as a decrease in the appropriate class of net assets in the statement of activities in the period acquired.

Example 2: Collection Items Received by Gift in a Merger

A43. Museum A and Museum B merge and Museum B is the acquirer. As part of the merger, Museum B acquires 500 paintings owned by Museum A. Museum B has a policy that requires the proceeds from sales of collection items to be used to acquire other items for collections. Museum B adds 450 of Museum A's paintings to its collection. The remaining 50 paintings acquired from Museum A are not suitable for the collection of the merged Museums. The fair values of Museum A's assets and liabilities at the acquisition date (other than collection items) are as follows:

Cash	$ 200
Accounts receivable	400
Contributions receivable	200
Fixed assets	800
Paintings (50 paintings)	100
Liabilities	(200)
Total	$1,500

A44. Museum B would recognize a contribution received of $1,500. No measurement of the collection items (the 450 paintings) would be required because it is clearly evident that those items were contributed as part of the merger. It is clearly evident that the items were contributed because the fair value of the identifiable net assets (excluding the collection items) exceeds the fair value of the liabilities assumed and consideration transferred for the acquiree, if any. That is, any value ascribed to the newly acquired collection items would increase the amount of the contribution received by Museum B in the merger. Consistent with Statement 116, contributed collection items that meet the criteria of that Statement should not be recognized as a contribution received.

Example 3: Collection Items Received in a Merger

A45. Museum C and Museum D merge and Museum D is the acquirer. To effectuate the merger, Museum D agrees to transfer cash consideration of $1,600 to a foundation that supports the education of future art students. As part of the merger, Museum D acquires 800 paintings owned by Museum C. Museum D has a policy that requires the proceeds from sales of collection items to be used to acquire other items for collections. Museum D adds all of Museum C's paintings to its collection. The fair value of Museum C's assets and liabilities at the acquisition date (other than collection items) are as follows:

Cash	$ 100
Accounts receivable	50
Contributions receivable	75
Fixed assets	675
Liabilities Assumed	(200)
Consideration Transferred	(1,600)
Total	$ (900)

A46. It is unclear whether the collection items were contributed or purchased because the fair value of the identifiable net assets (excluding the collection items) is less than the fair value of the liabilities assumed and consideration transferred for the acquiree. That is, the excess could be attributed wholly or in part to the collection items or goodwill purchased in the merger. In this circumstance, Museum D would need to determine whether the acquisition date fair values of the collection items are greater than $900.

A47. Assume that Museum D determines that the acquisition date fair values of the collection items are greater than $900. Museum D would presume that the excess relates to the collection and would attribute the $900 to the cost of those purchased collection items. Consistent with how purchased collections are recognized in Statement 116, that $900 cost would be recognized as a decrease in the appropriate class of net assets in the statement of activities in the period of the acquisition. No goodwill would be recognized.

A48. Instead of the circumstance described in paragraph A47, assume that Museum D determines that the acquisition date fair values of the collection items are less than $900. In this case, Museum D could not presume that the excess relates solely to the collection. Therefore, Museum D is required to determine the fair value of those purchased collection items, so that the remaining portion of the excess can be attributed to goodwill purchased. Assume the acquisition date fair values of the collection items are $300. Museum D would recognize goodwill of $600 and $300 as a decrease in the appropriate class of net assets in the statement of activities in the period of the acquisition.

Income Taxes (Application of Paragraph 35)

A49. Paragraph 35 requires that an acquirer measure any deferred tax asset or liability in accordance with FASB Statement No. 109, *Accounting for Income Taxes,* as amended. In accordance with that Statement, the acquirer is required to measure and recognize, separately from goodwill, a deferred tax asset or liability. Statement 109, as amended, sets out the subsequent accounting for deferred tax assets (including valuation allowances) and liabilities that were acquired in a merger or acquisition.

A50. The acquirer should also account for the potential tax effects of temporary differences and carryforwards of an acquiree that exist at the acquisition date and income tax uncertainties related to the acquisition (for example, an uncertainty related to the tax basis of an acquired asset that ultimately will be agreed to by the taxing authority or positions taken in prior tax returns of the acquiree) in accordance with the provisions of Statement 109, as amended and FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.*

Transfer of Consideration in Which the Acquirer Retains Control (Application of Paragraph 41)

A51. Paragraph 41 requires that an asset transferred by the acquirer to an unrelated third-party donee (or a liability incurred) as a required condition of a merger or acquisition be accounted for as consideration transferred for the acquiree. For example, assume an acquired not-for-profit organization ceases to exist as an independent entity and becomes a subsidiary of the acquirer. In that case, the predecessor board of directors of the acquired not-for-profit organization might designate another organization, such as a community foundation, to receive the consideration transferred by the acquirer. However, an acquirer that retains control over the future economic benefits of the transferred assets should account for that transfer as an asset-for-asset exchange, rather than as consideration transferred.

Example 4: Asset Transfer in Which Control over the Future Economic Benefits Is Retained by the Acquirer after the Acquisition

A52. An independent, not-for-profit community hospital (Hospital) agreed to be acquired by a nearby not-for-profit health care system (System). Hospital was in the midst of a major capital project at the acquisition date. To ensure completion of that capital project, Hospital's board of directors required that System transfer $20 million to a newly formed, unaffiliated foundation (Foundation) governed by a self-perpetuating board of directors. Foundation's initial board of directors is composed of the former board of directors of Hospital. The acquisition agreement requires that the $20 million be used to complete the project, if necessary, and that any assets remaining in Foundation on completion of the capital project would be used solely for future capital projects at Hospital.

A53. In this example, the acquirer has made a conditional transfer of assets to an unaffiliated organization as a required condition of the acquisition. However, because those assets may be used only for future capital additions at Hospital, System has retained control over the future economic benefits of those assets. A transferor that retains control over the economic benefits in the transferred assets has not transferred assets in exchange for the acquiree. Rather, that transferor has changed the nature of the asset (such as the conversion of cash into a receivable for future capital improvements from another entity). Asset transfers of that type should be accounted for as an asset-for-asset exchange rather than as consideration transferred.

Measurement Period (Application of Paragraphs 52–57 and 70(a))

A54. During the measurement period, the acquirer should adjust the provisional amounts recognized at the acquisition date or recognize additional assets or liabilities to reflect any new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement or recognition of the amounts of particular assets or liabilities as of that date. Some factors to consider in determining whether new information should result in a measurement period adjustment to the provisional amounts recognized are:

a. **The timing of the receipt of subsequent information.** Generally, new information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date.

b. **The type of subsequent information.** An actual exchange with a third party generally provides the best evidence of fair value.

c. **The size of the adjustment and the ability to identify the reason for the adjustment.** Significant gains and losses that do not have identifiable causes and that are recognized shortly after the acquisition date may be an indication of circumstances that existed at the acquisition date.

Example 5: Lawsuit

A55. NFP-C acquires NFP-D on December 31, 20X5. NFP-C recognizes a contribution received of $120,000 in the acquisition. One of the liabilities assumed in the acquisition is a liability for a lawsuit against NFP-D. At the acquisition date, NFP-C initially measures the fair value of the liability based on information obtained during the due diligence procedures and recognizes a provisional fair value for the liability of $95,000. Within the measurement period, NFP-C discovers information about the lawsuit against NFP-D. NFP-C determines that the information relates to facts that existed as of the acquisition date, and NFP-C revises its fair value measure of the liability as of the acquisition date to $80,000.

A56. In this example, the adjustment to the fair value of the liability ($15,000 reduction) would be accounted for as part of completing the initial accounting in the acquisition because the new information is obtained within the measurement period and relates to facts and circumstances that existed as of the acquisition date. The initial accounting for the acquisition would be adjusted and would result in an offsetting increase to the contributions received in the acquisition.

A57. In contrast, instead assume that a lawsuit is settled late in the measurement period for an amount that is different from the initial estimate. After assessing all of the facts and circumstances causing the difference, NFP-C determines there is no new information about facts that existed at the acquisition date. In that case, the difference would not be an adjustment to the initial accounting for the acquisition, but instead would be an adjustment to changes in net assets of the postcombination period.

Example 6: Disposal of an Asset during the Measurement Period

A58. NFP-E acquires NFP-F on September 15, 20X5. NFP-E recognizes goodwill of $20,000 in the acquisition. NFP-E measures and recognizes a provisional fair value of $1,000 for NFP-F's specialized (nonwasting) Asset A. NFP-E also seeks an independent appraisal of the fair value of Asset A. On December 15, 20X5, NFP-E sells Asset A to Third Party Co. for $1,750. The sale provides information about the fair value of Asset A. Depending on the circumstances, the adjustment(s) to the provisional fair value of Asset A ($750 increase) would be accounted for as part of completing the initial accounting for the acquisition, as current-period changes in net assets or, perhaps, partly as each. That determination would depend on whether the sale at $1,750 is indicative of the fair value that existed at the acquisition date or indicative of an increase in value that resulted from events and circumstances that occurred after the acquisition date.

A59. In this example, also assume that before agreeing to sell Asset A to Third Party Co., NFP-E receives the independent appraisal indicating a fair value of Asset A of $1,500 as of the acquisition date. In these circumstances, NFP-E would adjust the fair value of Asset A to the appraised value of $1,500 as of the acquisition date. The $500 adjustment to Asset A would result in an offsetting decrease to goodwill. The incremental $250 would be recognized as a gain on the sale of Asset A.

Example 7: Incomplete Appraisal (Illustration of Paragraphs 56 and 70(a))

A60. NFP-G acquires NFP-H on September 30, 20X5. NFP-G recognizes goodwill of $50,000 in the acquisition. NFP-G seeks an independent appraisal for an item of property, plant, and equipment acquired. However, the appraisal was not completed by the time NFP-G completed its 20X5 annual financial statements. NFP-G recognized in its 20X5 annual financial statements a provisional fair value for the asset of $30,000. The item of property, plant, and equipment had a remaining useful life at the acquisition date of five years. Four months after the acquisition date, NFP-G received the independent appraisal, which estimated the asset's fair value at the acquisition date as $40,000.

A61. As described in paragraph 56, NFP-G is required to recognize any adjustments to provisional values as a result of completing the initial accounting for the acquisition as if the initial accounting for the acquisition had been completed at the acquisition date. In its 20X6 financial statements, NFP-G presents a current-period balance sheet and a two-year comparative statement of activities. Therefore, in the 20X6 financial statements, an adjustment is made to the opening carrying amount of the item of property, plant, and equipment. That adjustment is measured as the fair value adjustment at the acquisition date of $10,000, less the additional depreciation that would have been recognized had the asset's fair value at the acquisition date been recognized from that date ($500 for 3 months' depreciation). The carrying amount of goodwill also is reduced for the reduction in value at the acquisition date of $10,000, and the 20X5 comparative information is adjusted to include additional depreciation of $500.

A62. In accordance with paragraph 70(a), NFP-G discloses:

a. In its 20X5 financial statements, that the initial accounting for the merger or acquisition has not been completed, and explains why
b. In its 20X6 financial statements, the amounts and explanations of the adjustments to the provisional values recognized during the current reporting period. Therefore, NFP-G discloses that the fair value of the item of property, plant, and equipment at the acquisition date has been increased by $10,000, with a corresponding decrease in goodwill. The 20X5 comparative information is adjusted to include additional depreciation of $500.

Assessing What Is Part of the Merger or Acquisition (Application of Paragraphs 58–60)

A63. Sometimes multiple transactions are bundled together. Therefore, paragraph 58 requires the acquirer to assess whether:

a. Any portion of the consideration transferred is for assets or liabilities related to something other than the acquired business or nonprofit activity
b. Any assets acquired or liabilities assumed are not part of the business or nonprofit activity.

A64. Only the consideration transferred for the business or nonprofit activity and the assets acquired or liabilities assumed or incurred that are part of the acquired business or nonprofit activity should be included in the acquisition accounting. The acquirer is required to make this assessment because the consideration transferred, assets acquired, and liabilities assumed in a merger or acquisition are the inputs for the acquirer's calculation of goodwill or contribution received.

A65. Judgment is required to determine whether a portion of the consideration transferred, or the assets acquired and liabilities assumed or incurred, are part of the merger or acquisition. This Statement requires that the acquirer consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction or event is arranged primarily for the economic benefit of the acquirer or resulting combined organization, rather than for the acquiree or its former owners.

a. **The reasons for the transaction or event—**Understanding the reasons why the parties to the merger or acquisition (the acquirer, the acquiree, and their owners, directors, managers, and their agents) entered into a particular transaction or arrangement may provide insight into whether it should be accounted for as part of the merger or acquisition. For example, if a transaction is arranged primarily for the economic benefit of the acquirer or consolidated entity with little or no benefit received by the acquiree or its former owners, that portion of the consideration transferred (and any related assets or liabilities) is unlikely to be part of the merger or acquisition and would be accounted for separately from the acquisition accounting.
b. **Who initiated the transaction or event—**Understanding who initiated the transaction or event may also provide insight into whether it should be accounted for as part of the merger or acquisition. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or consolidated entity with little or no benefit received by the acquiree or its former owners. Yet, a transaction or arrangement initiated by the owners of the acquiree is unlikely to be for the benefit of the acquirer or consolidated entity.
c. **The timing of the transaction or event—**The timing of the transaction or event may also provide insight into whether it should be accounted for as part of the merger or acquisition. For example, a transaction between the acquirer

and the acquiree that takes place during the negotiations of the terms of a merger or acquisition may be entered into in contemplation of the merger or acquisition for the purpose of providing future economic benefits to the acquirer or consolidated entity with little or no benefit received by the acquiree or its former owners.

Example 8: Asset Acquired from a Third-Party Donor That Is Included in the Acquisition Accounting

A66. To induce the acquisition of WO (Weak Organization) by SO (Strong Organization), as a condition of the acquisition between WO and SO, a third-party donor agrees to provide a cash contribution to support WO's mission. That assistance is transferred to SO (the consolidated entity) upon the closing of the acquisition agreement. The donor, as part of its mission and purpose, has an interest in supporting certain not-for-profit organizations. From the perspective of the donor, the assistance provided to induce SO to acquire WO is in the furtherance of its mission.

A67. In this case, the transaction was arranged primarily to achieve economic benefits favorable to the acquiree. Thus, that assistance would be an asset acquired at the acquisition date that is recognized as part of accounting for the acquisition. The cash assistance is also included in the acquisition accounting even though it is transferred to the resulting combined organization.

Arrangements to Pay for Employee Services

A68. Sometimes the terms of a merger or acquisition agreement may explicitly include payments or may trigger payments of severance options. Judgment is often required to determine whether arrangements to pay for employee services (compensation arrangements) should be accounted for as part of the merger or acquisition, which would affect the amount of goodwill or contribution received that is recognized in the merger or acquisition, or whether they should be accounted for separately from the merger or acquisition, which would result in compensation expense in the period(s) after the merger or acquisition.

A69. To assist in that determination, 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. To the extent that it is, that portion of the consideration transferred (and any related liabilities) should be accounted for separately from the merger or acquisition. As described in paragraph 59, understanding the reasons for the arrangement, who initiated the arrangement, and when the arrangement was entered into may also assist in determining whether the arrangement should be accounted for as part of the acquisition accounting or separately.

A70. If it is not clear whether an arrangement to pay for employee services should be accounted for as part of the merger or acquisition or separately from the merger or acquisition, the following indicators also should be considered:

a. **Continuing employment—**If future payments are automatically forfeited if employment ends, the arrangement may be compensation for postcombination services that will benefit the consolidated entity and should be accounted for separately from the merger or acquisition. In contrast, if future payments are not automatically forfeited if employment ends, the arrangement may be part of the consideration transferred for the acquiree.

b. **Duration of continuing employment—**An employment agreement with an employment period coinciding with or longer than the future payment period may indicate that the arrangement is compensation for postcombination services that will benefit the consolidated entity and should be accounted for separately from the acquisition accounting.

c. **Level of payment—**Reduced payments to owners who do not become employees may indicate that the incremental payments to selling owners who become employees are payments for postcombination services that will benefit the consolidated entity and should be accounted for separately from the acquisition accounting. In contrast, payments in excess of reasonable levels paid to employees with similar responsibilities may indicate that the payment is part of the consideration transferred for the acquiree.

d. **Formula for determining consideration—**Contingent payments that are based on multiples of future earnings, future cash flows, or other similar performance measures may indicate that the formula is intended to verify the fair value of the acquiree and, therefore, should be accounted for as part of the merger or acquisition. In contrast, contingent payments based on percentages of earnings may indicate a profit-sharing arrangement that should be accounted for separately from the acquisition.

Effective Settlement of Preexisting Relationships between the Acquirer and the Acquiree in a Merger or Acquisition

A71. The acquirer and acquiree may have a relationship that existed before the merger or acquisition was contemplated. For purposes of this Statement, those relationships are called *preexisting relationships.* A preexisting relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or licensor and licensee) or noncontractual (for example, plaintiff and defendant).

A72. In general, the effective settlement of a preexisting relationship between the acquirer and acquiree should be accounted for in the same way whether it is settled as part of a merger or acquisition or separately. Therefore, if the merger or acquisition results in the effective settlement of a preexisting relationship, the acquirer recognizes a gain or loss and measures it as follows:

a. A noncontractual preexisting relationship (such as a lawsuit) should be measured at fair value.

b. A contractual preexisting relationship should be measured as the lesser of the following:

(1) The amount by which the contract is favorable or unfavorable from the perspective of the acquirer when compared with pricing for current market transactions for the same or similar items

(2) Any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavorable.

To the extent that (2) is less than (1), the difference should be included as part of the merger or acquisition accounting. Also, an unfavorable contract is not necessarily a loss contract for the acquirer.

A73. A preexisting relationship may be a contract between the acquirer and the acquiree in which the acquirer had previously granted to the acquiree the right to use the acquirer's recognized or unrecognized intangible assets (for example, a right to use the acquirer's trade name under a franchise agreement). In that case, paragraph 17 requires that the acquirer recognize an intangible asset for that right separately from goodwill as part of the merger or acquisition. However, if the contract includes terms that are favorable or unfavorable when compared with pricing for current market transactions for the same or similar items, the acquirer should recognize a gain or loss separately from the merger or acquisition for the effective settlement of the contract. The gain or loss is measured in accordance with paragraph A72.

Acquisitions of Less Than 100 Percent of the Acquiree's Equity Ownership Interests

A74. In an acquisition in which the acquirer holds less than 100 percent of the equity ownership interests of the acquiree at the acquisition date, the acquirer shall:

a. Recognize identifiable assets acquired and liabilities assumed at 100 percent of their acquisition-date values measured in accordance with paragraphs 15–36.

b. Recognize either goodwill or an inherent contribution received, measured as follows:

   (1) If the acquirer transfers consideration in exchange for a controlling interest in the acquiree and the acquisition date values of the consideration transferred and acquirer's portion of the liabilities assumed exceed the acquirer's portion of the acquisition date values of the identifiable assets acquired, the acquirer shall recognize that excess as purchased goodwill. Any purchased goodwill shall be assigned to the acquirer (that is, the controlling interest).

   For example, if the acquirer transferred consideration of $10,000 for an 80 percent controlling ownership interest in the acquiree and recognized identifiable assets of $100,000 and liabilities of $97,000 in accordance with this Statement, the acquirer would recognize goodwill of $7,600 ($10,000 – [80 percent × ($100,000 – $97,000)]). The purchased goodwill of $7,600 should be assigned to the controlling interest.

(2) If the acquirer does not transfer consideration for a controlling interest in the acquiree and the acquisition date values of 100 percent of the liabilities assumed exceeds 100 percent of the acquisition date values of the identifiable assets acquired (a net deficit combination), the acquirer shall recognize that excess as goodwill. In a net deficit combination, goodwill shall be allocated between the controlling and the noncontrolling ownership interests based on their equity percentages.

For example, if the acquirer acquired a 90 percent controlling ownership interest in the acquiree and recognized identifiable assets of $160,000 and liabilities of $200,000 in accordance with this Statement, the acquirer would recognize goodwill of $40,000 ($200,000 – $160,000). $36,000 (90 percent × $40,000) of the goodwill should be allocated to the controlling interest, and $4,000 (10 percent × $40,000) of the goodwill should be allocated to the noncontrolling ownership interest.

(3) If the acquisition date values of 100 percent of the identifiable assets acquired exceed 100 percent of the liabilities assumed, the acquirer shall recognize that excess as an inherent contribution received. Any inherent contributions received shall be allocated between the controlling and noncontrolling ownership interests based on their equity percentages.

For example, if the acquirer acquired a 75 percent controlling ownership interest in the acquiree and recognized identifiable assets of $125,000 and liabilities of $100,000 in accordance with this Statement, the acquirer would recognize a contribution received of $25,000 ($125,000 – $100,000). $18,750 (75 percent × $25,000) of the contribution received should be allocated to the controlling interest, and $6,250 (25 percent × $25,000) of the contribution received should be allocated to the noncontrolling ownership interest.

c. Recognize and measure the noncontrolling ownership interest as the sum of the noncontrolling ownership interest's proportional interest in the identifiable assets acquired and liabilities assumed and, if a net deficit combination, the amount of goodwill allocated to the noncontrolling ownership interests.

Acquisitions Achieved in Stages or Steps

A75. In a step acquisition, an acquirer holds a noncontrolling ownership investment in an acquiree immediately before obtaining control of that acquiree. In accounting for a step acquisition, the acquirer shall remeasure its noncontrolling ownership investment in the acquiree at fair value as of the acquisition date and recognize any gain or loss in the statement of activities. Once the acquirer has obtained control of the acquiree, subsequent acquisitions (or dispositions) of any interests in the acquiree shall be accounted for in accordance with proposed FASB Statement, *Consolidated Financial Statements,* *Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries,* including guidance provided in Appendix D of this Statement.

Illustrations of Presentation in the Statement of Activities (Application of Paragraph 61(a))

Example 9: Donor Restrictions on an Acquiree's Assets

A76. Assume that Charity A merges with another not-for-profit organization (Charity B), to form Charity AB. Charity A, the acquiring organization, assumes Charity B's liabilities and transfers no consideration in exchange for Charity B. The fair values of Charity B's assets and liabilities at the acquisition date are:

Cash	$ 75	Unrestricted net assets	$ 550
Contributions receivable	225	Temporarily restricted net assets	250
Long-term investments	500	Permanently restricted net assets	200
Plant, property and equipment	430	Total net assets	$1,000
Total assets	1,230		
Accounts payable	(65)		
Mortgage	(165)		
Total net assets	$1,000		

A77. Charity A recognizes a $1,000 contribution received in the merger (the excess of the acquisition date values of the identifiable assets acquired over the sum of the acquisition date values of the liabilities assumed). Consistent with the provisions of Statement 116, Charity AB classifies the recognized contributions received based on the type of donor-imposed restrictions, including those imposed by the donor of the business or nonprofit activity acquired, if any. Based on donor restrictions on Charity B's net assets at the acquisition date, net assets with a fair value of $250 and $200 were classified as temporarily restricted and permanently restricted net assets, respectively. In this example, no donor restrictions are imposed by the donor of Charity A. To recognize the fiduciary responsibilities to the donors of Charity B that are assumed when Charity B's assets and liabilities are acquired, Charity AB would classify changes to its net assets as follows:

Increase in unrestricted net assets:
Contribution received in the merger with Charity B–$550

Increase in temporarily restricted net assets:
Contribution received in the merger with Charity B–$250

Increase in permanently restricted net assets:
Contribution received in the merger with Charity B–$200

Example 10: Donor Restrictions as a Result of a Merger or Acquisition

A78. Assume that Charity A merges with a former subsidiary of Parent (Charity B), to form Charity AB. Charity A, the acquiring organization, assumes Charity B's liabilities and transfers no consideration in exchange for Charity B. The fair value of Charity B's assets and liabilities at the acquisition date is:

Cash	$ 75
Contributions receivable	225
Long-term investments	500
Plant, property, and equipment	430
Total assets	1,230
Accounts payable	(65)
Mortgage	(165)
Total net assets	$1,000

Unrestricted net assets	$ 550
Temporarily restricted net assets	250
Permanently restricted net assets	200
Total net assets	$1,000

A79. Charity A recognizes a $1,000 contribution received in the merger (the excess of the acquisition date values of the identifiable assets acquired over the sum of the acquisition date values of the liabilities assumed). Consistent with the provisions of Statement 116, Charity AB classifies the recognized contributions received based on the type of donor-imposed restrictions, including those imposed by the donor of the business or nonprofit activity acquired, if any. Based on donor restrictions on Charity B's net assets at the acquisition date, net assets with a fair value of $250 and $200 were classified as temporarily restricted and permanently restricted net assets, respectively. As a condition of the merger, Parent's governing board requires that Charity AB use $175 of unrestricted net assets for future capital improvements to the facility acquired. The requirement is irrevocable and is not self-imposed. To recognize the fiduciary responsibilities to the donors of Charity B that are assumed when Charity B's assets and liabilities are acquired, Charity AB would classify changes to its net assets as follows:

Increase in unrestricted net assets:

Contribution received in the merger with Charity B–$375

Increase in temporarily restricted net assets:

Contribution received in the merger with Charity B–$425

Increase in permanently restricted net assets:

Contribution received in the merger with Charity B–$200

Illustration of Presentation in the Cash Flow Statement (Application of Paragraph 63)

A80. A not-for-profit organization (Organization X) acquires Organization S from Organization S's parent. As part of the acquisition, Organization S's parent requires that Organization X transfer consideration of $300 to a third-party community foundation. The fair values of Organization S's assets and liabilities at the acquisition date are:

Cash	$ 25
Contributions receivable	155
Property, plant, and equipment	900
Long-term note payable	(375)
Net assets acquired	$705

A81. Organization X reports the acquisition as a single line in the investing activities section of the statement of cash flows, as follows:

Payment for acquisition of Organization S, net of cash acquired	($275)

A82. Organization X discloses the following additional information in a supplemental schedule of noncash investing and financing activities:

> The Organization acquired Organization S by transferring cash of $300. In conjunction with the acquisition, liabilities were assumed and a contribution was received from Organization S's parent as follows:

Fair value of assets acquired	$1,080
Cash transferred to community foundation	(300)
Liabilities assumed	(375)
Contribution received in acquisition of Organization S	$ 405

Continuing Authoritative Guidance

A83. Paragraphs A84–A100 provide continuing authoritative guidance for asset acquisitions that are not mergers or acquisitions, mergers and acquisitions that were accounted for by the pooling-of-interests (pooling) method prior to the adoption of this Statement, and transactions between entities under common control. The guidance in this appendix has been quoted, paraphrased, or modified as necessary so that it can be understood in the context of this Statement. The original source of the guidance is noted parenthetically or otherwise. The Board may reconsider that guidance at a later date in another project.

Asset Acquisitions That Are Not Mergers or Acquisitions

A84. As noted in paragraph 2 of this Statement, a transaction or event is accounted for as a merger or acquisition only if the assets acquired and liabilities assumed constitute a business or nonprofit activity (an acquiree). If the assets acquired and liabilities assumed do not constitute a business or nonprofit activity, the acquirer should account for the transaction as an asset acquisition, which is described in paragraphs A85–A90 or in accordance with other applicable generally accepted accounting principles.

A85. (FAS 141, ¶4) **Initial recognition.** Assets are commonly acquired in exchange transactions that trigger the initial recognition of the assets acquired and any liabilities assumed. If the consideration given in exchange for the assets (or net assets) acquired is in the form of assets surrendered (such as cash), the assets surrendered are derecognized at the date of acquisition. If the consideration given is in the form of liabilities incurred or equity interests issued, the liabilities incurred and equity interests issued are initially recognized at the date of acquisition (APB Opinion No. 16, *Business Combinations,* paragraph 67).

A86. (FAS 141, ¶5) **Initial measurement.** Like other exchange transactions, asset acquisitions are generally measured on the basis of the fair values exchanged. In exchange transactions, the fair values of the net assets acquired and the consideration paid are assumed to be equal in the absence of evidence to the contrary. Thus, the **cost**[12] of an asset acquisition to the acquiring entity is equal to the fair values exchanged, and no gain or loss is recognized except for the gain or loss that is recognized if the fair value of noncash assets given as consideration differs from the assets' carrying amounts on the acquiring entity's books (Opinion 16, paragraph 67).

A87. (FAS 141, ¶6) Asset acquisitions in which the consideration given is cash are measured by the amount of cash paid, which generally includes the transaction costs of the asset acquisition. However, if the consideration given is not in the form of cash (that is, in the form of noncash assets, liabilities incurred, or equity interests issued), measurement is based on the fair value of the consideration given, which also generally includes the transaction costs of the asset acquisition, or the fair value of the assets (or net assets) acquired, whichever is more clearly evident and, thus, more reliably measurable (Opinion 16, paragraph 67).

A88. (FAS 141, ¶7, FAS 142, ¶9) **Allocating cost.** Acquiring assets in groups requires not only ascertaining the cost of the asset (or net asset) group but also allocating that cost to the individual assets (or individual assets and liabilities) that make up the group. The cost of such a group is determined using the concepts described in paragraphs A86 and A87. The cost of a group of assets acquired in an asset acquisition is allocated to the individual assets acquired or liabilities assumed based on their relative fair values and does not give rise to goodwill (Opinion 16, paragraph 68).

A89. Additionally, the accounting for an asset acquisition differs from the accounting for mergers and acquisitions by a not-for-profit organization in the following respects:

a. Intangible assets acquired in an asset acquisition are recognized in accordance with Statement 142, not in accordance with this Statement.

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[12]*Cost* is a term that is often used to refer to the amount at which an entity initially recognizes an asset at the date it is acquired, whatever the manner of acquisition.

b. In-process research and development assets acquired in an asset acquisition are accounted for in accordance with FASB Statement No. 2, *Accounting for Research and Development Costs*, as amended, not in accordance with Statement 142.

c. Contingent consideration related to an asset acquisition and contingencies acquired in an asset acquisition are accounted for in accordance with FASB Statement No. 5, *Accounting for Contingencies*, not in accordance with this Statement.

A90. (FAS 141, ¶8) **Accounting after acquisition.** The nature of an asset or liability determines an acquirer's subsequent accounting for the asset or liability. The basis for measuring the asset acquired or liabilities assumed—whether the cost, the fair value of an asset received or given up, the fair value of a liability incurred, or the fair value of equity shares issued—has no effect on the subsequent accounting for the asset or liability (Opinion 16, paragraph 69).

Mergers and Acquisitions That Were Accounted for by the Pooling Method

A91. This Statement prohibits the use of the pooling method in accounting for mergers and acquisitions by a not-for-profit organization. That prohibition should be applied prospectively as of the beginning of the annual period in which this Statement is first applied but no later than annual periods beginning on or after [date to be inserted after exposure]. The following paragraphs carry forward, without reconsideration, guidance in Statement 141 (some of which was carried forward from Opinion 16 and its interpretations) that may be helpful in accounting for subsequent asset dispositions for mergers and acquisitions to which the pooling method was applied.

Disposition of Assets After a Merger or Acquisition Accounted for Using the Pooling Method

A92. (FAS 141, ¶D9) Following a merger or acquisition accounted for by the pooling method, the combined entity might dispose of assets of the previously separate entities. Unless those disposals are part of customary activities of the combined entity, any gain or loss recognized resulting from that disposition might be required to be recognized as an extraordinary item. Recognition as an extraordinary item is warranted because the pooling method of accounting would have been inappropriate if the combined entity had made a commitment or had planned to dispose of a significant part of the assets of one of the combining entities.

A93. (FAS 141, ¶D10) The combined entity should recognize the gain or loss resulting from the disposal of a significant part of the assets or a separable segment of the previously separate entities, less applicable income tax effect (if any), as an extraordinary item if (a) the gain or loss is material in relation to the combined entity and (b) the disposition is within two years after the combination is consummated (Opinion 16, paragraph 60).

Transactions between Entities under Common Control

A94. (FAS 141, ¶D11) Consistent with the provisions of Statement 141 and Opinion 16, paragraph 3 states that this Statement does not apply to mergers and acquisitions involving only entities under common control. The following are examples of those types of transactions:

a. An entity charters a newly formed entity and then transfers some or all of its net assets to that newly chartered entity.
b. A parent company transfers the net assets of a wholly owned subsidiary into the parent company and liquidates the subsidiary. That transaction is a change in legal organization but not a change in the reporting entity.
c. A parent company transfers its interest in several partially owned subsidiaries to a new wholly owned subsidiary. That also is a change in legal organization but not in the reporting entity.

A95. (FAS 141, ¶D12) When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests should initially recognize the assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer.

Procedural Guidance

A96. (FAS 141, ¶D14) Some transfers of net assets or exchanges of shares between entities under common control result in a change in the reporting entity. In practice, the method that many entities have used to account for those transactions is similar to the pooling method. Certain provisions in Opinion 16 relating to application of the pooling method provided a source of continuing guidance on the accounting for transactions between entities under common control. Paragraphs A97–A100 provide procedural guidance that should be considered when preparing financial statements and related disclosures for the entity that receives the net assets.

A97. (FAS 141, ¶D15) In some instances, the entity that receives the net assets or equity interests (the receiving entity) and the entity that transferred the net assets or equity interests (the transferring entity) may account for similar assets and liabilities using different accounting methods. In such circumstances, the carrying values of the assets and liabilities transferred may be adjusted to the basis of accounting used by the receiving entity if the change would be preferable. Any such change in accounting method should be applied retrospectively, and financial statements presented for prior periods should be adjusted unless it is impracticable to do so. FASB Statement No. 154, *Accounting Changes and Error Corrections*, provides guidance if retrospective application is impracticable (Opinion 16, paragraph 52).

A98. (FAS 141, ¶D16) The financial statements of the receiving entity should report changes in net assets for the period in which the transfer occurs as though the transfer of net assets or exchange of equity interests had occurred at the beginning of the period. Changes in net assets for that period will thus comprise those of the previously separate entities combined from the beginning of the period to the date the transfer is completed and those of the combined operations from that date to the end of the period. By eliminating the effects of intercompany transactions in determining the changes in net assets for the period before the combination, those results will be on substantially the same basis as the changes in net assets for the period after the date of combination. The effects of intercompany transactions on current assets, current liabilities, revenue, and cost of sales for periods presented and on net assets at the beginning of the periods presented should be eliminated to the extent possible (Opinion 16, paragraph 56).

A99. (FAS 141, ¶D17) Similarly, the receiving entity should present the statement of financial position and other financial information as of the beginning of the period as though the assets and liabilities had been transferred at that date. Financial statements and financial information presented for prior years also should be restated to furnish comparative information. All restated financial statements and financial summaries should indicate clearly that financial data of previously separate entities are combined (Opinion 16, paragraph 57).

A100. (FAS 141, ¶D18) Notes to financial statements of the receiving entity should disclose the following for the period in which the transfer of assets and liabilities or exchange of equity interests occurred:

a. The name and brief description of the entity included in the reporting entity as a result of the net asset transfer or exchange of equity interests
b. The method of accounting for the transfer of net assets or exchange of equity interests.

The receiving entity also should consider whether additional disclosures are required in accordance with FASB Statement No. 57, *Related Party Disclosures.*

Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

Paragraph Numbers

Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

B1. This appendix summarizes the Board's considerations in reaching the conclusions in this proposed Statement. It includes the reasons why the Board accepted particular approaches and rejected others. Individual Board members gave greater weight to some factors than to others.

B2. This proposed Statement addresses the financial information reported for mergers and acquisitions by not-for-profit organizations, including the accounting for goodwill and other intangible assets. The Board's primary objective in this proposed Statement is to improve the accounting for and the relevance, reliability, comparability, and understandability of that information.

Background Information

Current Guidance and Practice

B3. In the past, neither the FASB nor the AICPA has undertaken an effort to comprehensively address the accounting and reporting for a merger or acquisition by a not-for-profit organization, resulting in an absence of guidance for those transactions. Because of that absence in guidance, the Accounting Standards Executive Committee (AcSEC) of the AICPA considered whether a not-for-profit organization should apply APB Opinion No. 16, *Business Combinations.* AcSEC concluded that the nature and kinds of transactions addressed in Opinion 16 apply to the kinds of transactions in which not-for-profit organizations engage, as discussed in its Statement of Position (SOP) 94-2, *The Application of the Requirements of Accounting Research Bulletins, Opinions of the Accounting Principles Board, and Statements and Interpretations of the Financial Accounting Standards Board to Not-for-Profit Organizations.*

B4. The criteria for applying the pooling-of-interests (pooling) method include an exchange of common stock of the combining entities; however, not-for-profit organizations generally do not have common stock. Thus, AcSEC considered whether that method should ever be applied to mergers and acquisitions by not-for-profit organizations. At that time, business entities were applying Opinion 16 and, therefore, were using the pooling method if the criteria to apply that method were met. AcSEC concluded that in certain circumstances, the pooling method better reflects the substance of a merger or acquisition by a not-for-profit organization than does the acquisition method (formerly known as the purchase method). An example of those circumstances that AcSEC cited was the formation of a new organization through the combination of two or more existing organizations without the exchange of consideration.

B5. Additional guidance on accounting for mergers and acquisitions of health care organizations is included in the AICPA Audit and Accounting Guide, *Health Care Organizations.* That guidance describes mergers and acquisitions that involve the receipt or payment of monetary consideration, the change in legal title to assets, or the assumption of liabilities as being similar to a purchase transaction. Transactions that result in a change in control (for example, through a change in an organization's sole corporate member) are described as being similar to a pooling.

B6. Because of the nature of the limited guidance described above, many mergers and acquisitions by not-for-profit organizations are currently accounted for in a manner similar to the pooling method. However, there is some diversity in practice. For example, some apply the acquisition method to all mergers and acquisitions that involve a change in control, whereas others apply the pooling method to those mergers and acquisitions **unless** monetary consideration has been exchanged.

Improving the Accounting for Mergers and Acquisitions

B7. The Board added a project on accounting for business combinations to its agenda in August 1996. That project included the accounting and reporting for mergers and acquisitions by all types of entities, including not-for-profit organizations. The objective of that project was to improve the transparency of accounting and reporting of business combinations by reconsidering the requirements that existed at that time. The Board observed that the application of Opinion 16 and its related guidance could result in two economically similar transactions being accounted for by different methods. Those different methods produce dramatically different financial statement results and reduce the faithful representation and the comparability of the financial statements.

B8. In 1999, the Board affirmed its decision that its project on business combinations should include mergers and acquisitions by not-for-profit organizations. Later that year, the Board decided to separate the project on mergers and acquisitions by not-for-profit organizations from the main project on business combinations.

B9. At the outset of the project on mergers and acquisitions by not-for-profit organizations, the Board held an open educational meeting with members of the FASB's resource group. Input from that meeting helped the Board reach its decisions on several key issues, including the method of accounting for mergers and acquisitions by not-for-profit organizations and the criteria to be used to identify the acquiring not-for-profit organization. Throughout the project, the Board and staff continued to receive technical support from members of the resource group, as well as other constituents and industry groups.

B10. The Board's project on mergers and acquisitions by not-for-profit organizations addresses three primary areas:

a. The method of accounting for those mergers and acquisitions and the application of the acquisition method (the requirements included in this proposed Statement)

b. The accounting for goodwill and other intangible assets acquired in a merger or acquisition
c. The accounting for a noncontrolling ownership interest in a subsidiary. (Those requirements are included in Appendix D of this proposed Statement.)

The Board deliberated the issues at 20 public decision-making meetings. The decisions reached are included in this proposed Statement and proposed FASB Statement, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition.*

Project Approach

B11. When beginning the development of this proposed Statement, the Board affirmed its belief that accounting standards should result in accounting for similar transactions and circumstances similarly and accounting for different transactions and circumstances differently. Thus, the overall approach in this project has been that the standards for for-profit entities, including changes in proposed FASB Statement, *Business Combinations,* (proposed Statement 141(R)), are relevant to not-for-profit organizations unless circumstances unique to not-for-profit organizations justify a departure from those standards. The Board then considered whether the standards result in benefits of decision-useful information that outweigh the costs of providing that information to the users of the financial statements of not-for-profit organizations.

B12. The Board has begun its redeliberations on proposed Statement 141(R) and is in the process of considering potential revisions to that guidance before it is issued as a final Statement. The Board plans to consider how those revisions would affect this proposed Statement and whether to make conforming changes in the guidance for not-for-profit organizations. Readers may access the FASB's website for the Board's conclusions on its project, Business Combinations: Applying the Acquisition Method, to gain insight about which portions of this proposed Statement may change, independent of the comments made about this Exposure Draft.

Accounting for Business Combinations by For-Profit Entities

B13. In June 2001, the Board issued FASB Statements No. 141, *Business Combinations,* and No. 142, *Goodwill and Other Intangible Assets.* The fundamental improvements included in those Statements are:

a. **Eliminating the treatment alternative for the accounting for business combinations.** Statement 141 eliminated the pooling method for for-profit entities. The benefit of that change is that similar transactions are accounted for similarly, which provides comparable information in the financial statements.
b. **Establishing consistency for the criteria used to identify the acquirer.** Statement 141 requires that an acquirer be identified in all business combinations. While that identification depends on the individual facts and circumstances, Statement 141 provides factors to consider when making that determination. The benefit of that change is that the guidance adds further

consistency in determining which entity is the acquirer, which increases the comparability of the information in the financial statements.

c. **Providing information about the intangible assets that are acquired in a business combination.** Statement 141 requires an acquirer to recognize intangible assets acquired in a business combination apart from goodwill and provides criteria and guidance for that recognition. The benefit of that requirement is that the acquirer's financial statements provide more relevant and complete information about the assets acquired in business combinations.

B14. The Board also proposed improvements to the application of the acquisition method to improve the completeness, relevance, and comparability of financial information about business combinations provided in financial statements. In the application of the acquisition method, the FASB and the International Accounting Standards Board (IASB) agreed to develop jointly a single, high-quality accounting standard that could be used for both international and domestic financial reporting. The Exposure Draft resulting from that joint FASB-IASB project was issued for comment in June 2005 as proposed Statement 141(R). The Boards are currently redeliberating those proposals.

B15. Proposed Statement 141(R) seeks to improve financial reporting by requiring that:

a. The acquisition method be applied to more business combinations, including those involving only mutual entities and those achieved by contract alone.
b. An acquirer recognize an acquired business at its fair value as of the acquisition date rather than at its accumulated cost of the combination.
c. An acquirer recognize and measure the individual assets acquired and liabilities assumed at their acquisition date fair values, with limited exceptions.

The Board's deliberations related to business combinations achieved in stages also led to the Board comprehensively reconsidering the accounting and reporting of a noncontrolling ownership interest in a subsidiary. That reconsideration led to the issuance of proposed FASB Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*, which was issued concurrently with proposed Statement 141(R).

B16. Statement 141 and proposed Statement 141(R) specifically exclude from their scope mergers and acquisitions between not-for-profit organizations and acquisitions of a business entity by a not-for-profit organization. Those mergers and acquisitions are the focus of this proposed Statement. Additionally, the effective date for changes to the accounting for noncontrolling ownership interests in the proposed Statement on consolidated financial statements is deferred for not-for-profit organizations until interpretative guidance is issued. Therefore, many of the accounting and reporting improvements that have already been realized by acquirers that are business entities or that have been introduced in proposed Statement 141(R) and the proposed Statement on noncontrolling ownership interests also would be realized by not-for-profit acquirers by applying this proposed Statement and proposed changes to the accounting for goodwill and other intangible assets.

Circumstances Unique to Mergers and Acquisitions by Not-for-Profit Organizations

B17. Consistent with AcSEC's conclusions in SOP 94-2, the Board observed that there are many similarities between mergers and acquisitions by not-for-profit organizations and mergers and acquisitions by business entities. The Board also observed that not-for-profit organizations possess some characteristics that distinguish them from business entities. Thus, the work in this project focused on identifying and analyzing those differences between not-for-profit organizations and business entities and the mergers and acquisitions in which they engage. Throughout the course of the project, the Board then considered how the similarities and differences between business entities and not-for-profit organizations should affect the financial accounting and reporting requirements for mergers and acquisitions.

B18. The Board identified a fundamental difference between mergers and acquisitions by not-for-profit organizations and business combinations. That fundamental difference has financial accounting and reporting implications. The difference exists in mergers and acquisitions in which both the acquirer and the acquiree are not-for-profit organizations. Because a not-for-profit acquiree lacks ownership interests like business entities, negotiations in some of those mergers and acquisitions focus on the furtherance of the mission, governance, and programs for the benefit of the public, rather than focusing on maximizing returns for equity holders. Many mergers and acquisitions by not-for-profit organizations do not involve an exchange of consideration other than the assumption of the acquiree's liabilities. Thus, many of those transactions or events are nonreciprocal and include a contribution received by the acquirer.

B19. The Board was mindful of the wide and varied spectrum of not-for-profit organizations throughout the development of this proposed Statement. For example, organizations that are considered nongovernmental not-for-profit organizations for purposes of applying generally accepted accounting principles (GAAP) include most human service organizations, churches, foundations, museums, colleges and universities, and some other organizations, such as certain health care organizations and hospitals. Some of those organizations receive significant portions of their support from sources other than the sale of goods and services, while others receive their primary support from the sale of goods and services. Therefore, certain transactions described in this proposed Statement would be relevant to various sectors of not-for-profit organizations but would not be relevant to other sectors.

Benefits and Costs

B20. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement a new standard are borne primarily by the reporting entity. The Board's assessment of the benefits and costs of issuing an accounting standard is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement an accounting standard or to quantify the value of improved information in financial statements.

B21. The Board believes that the requirements of this proposed Statement would result in improved financial reporting in several ways. Some of those benefits have already been achieved for business entities through the issuance of Statements 141 and 142 in June 2001, which are delayed for not-for-profit organizations. This proposed Statement would result in the following improvements:

a. **Improve the comparability of reported financial information.** This proposed Statement would require that not-for-profit organizations account for all mergers and acquisitions using a single method—the acquisition method. Not-for-profit organizations currently apply Opinion 16 by analogy. That Opinion and related interpretative guidance permit the use of the pooling method in circumstances in which there have been no exchanges of consideration; otherwise, the purchase method should be used. (Note that Opinion 16 continues to use the term *purchase method* instead of the *acquisition method.* Therefore, this proposed Statement refers to the purchase method whenever referencing that Opinion.) Because an organization can choose whether to use the pooling or purchase method in certain transactions, economically similar transactions are being accounted for using different methods that produce dramatically different financial results.
b. **Provide more complete financial information.** The explicit criteria for recognition of intangible assets apart from goodwill in this proposed Statement would provide more information about the assets acquired and liabilities assumed in mergers and acquisitions. Not-for-profit organizations currently analogize to Opinion 16, which requires the recognition of intangible assets apart from goodwill. However, the Opinion 16 criteria for determining whether an acquired intangible asset should be recognized apart from goodwill are vague and often result in intangible assets not being separately identified and recognized, but instead being subsumed into goodwill.
c. **Better reflect the value of the assets received and liabilities assumed.** This proposed Statement would require an acquirer to recognize the identifiable assets acquired and liabilities assumed at their acquisition date fair values regardless of whether the acquisition results from a merger, purchase, contribution, or other means. Not-for-profit organizations currently analogize to Opinion 16, which requires the use of the acquiree's carryover basis (for the pooling method) or an allocation of the cost based on "estimated fair values" (for the purchase method). Some of the Opinion 16 purchase method requirements are inconsistent with fair value measurement objectives.
d. **Better reflect the contributions that are received in some mergers and acquisitions by not-for-profit organizations.** This proposed Statement would require an acquirer to recognize a contribution received in circumstances in which the sum of the fair values of the identifiable assets acquired exceed the fair values of the liabilities assumed and any consideration transferred. Those not-for-profit organizations that currently use the pooling method do not recognize any contribution received. Additionally, it appears

that some of those not-for-profit organizations that use the purchase method do not recognize any contribution received and currently reduce the amounts assigned to noncurrent assets acquired and possibly recognize negative goodwill.

e. **Improve the comparability and the usefulness of disclosures.** This proposed Statement would provide broad requirements for the acquirer to disclose information about the financial effects of a merger or acquisition. That information would be required for all acquiring organizations and would be useful in making resource allocation decisions, in assessing services and ability to provide services, and in assessing management's stewardship and performance.

B22. Additionally, like proposed Statement 141(R), by focusing on the fundamental requirements for recognizing and measuring all mergers and acquisitions, this proposed Statement would assist the Board in establishing principles-based standards that simplify GAAP whenever possible while improving the comparability and understanding of the resulting information. The requirements in this proposed Statement and the principles in proposed Statement 141(R) are similar, yet those requirements and the application guidance in this proposed Statement would take into consideration characteristics and common transactions and events by not-for-profit organizations, such as receiving contributions of a business or nonprofit activity and acquiring permanent collection items.

B23. The Board sought to reduce the costs of applying this proposed Statement without significantly reducing the expected benefits. The Board believes that this proposed Statement would do that by:

a. Requiring that goodwill or a contribution received be measured by comparing the acquisition date values[13] of the identifiable assets acquired with the acquisition date values of the liabilities assumed and any consideration transferred in exchange for the acquiree. That requirement would be an exception to the principle in proposed Statement 141(R) that would require the measurement of the fair value of the acquiree as a whole in measuring goodwill.
b. Requiring that particular assets and liabilities (for example, those related to certain collection items, deferred taxes, pensions, and other postemployment benefits) continue to be recognized and measured in accordance with existing accounting standards rather than at fair value.
c. Applying its provisions prospectively rather than retrospectively.

The Board acknowledges that those steps may result in some sacrifice to the benefits of improved financial reporting in accordance with this proposed Statement. However, the Board believes that the benefits would not justify the complexities and related costs that

[13]The *acquisition date values* refer to the amounts assigned to recognized assets and liabilities as would be required by this proposed Statement, which, with limited exceptions, is fair value at the acquisition date.

would result from imposing the fair value measurement requirement to the acquiree and to all assets and liabilities and from requiring retrospective application at this time.

Basis for Conclusions

Methods of Accounting

B24. The Board concluded that using a single method of accounting that results in similar transactions and events being accounted for similarly improves the relevance, faithful representation, comparability, and understandability of financial information about mergers and acquisitions by not-for-profit organizations. In this project, the Board considered whether the reasons that support the use of the acquisition method for business combinations also apply to all mergers and acquisitions by not-for-profit organizations. The Board considered each of the three alternative accounting methods (the acquisition method, the pooling method, and the fresh-start method) before concluding that the acquisition method should be used for all business combinations.

Reasons for Adopting the Acquisition Method

B25. Paragraph 7 of this proposed Statement would require a not-for-profit organization to account for a merger or acquisition by applying the acquisition method described in this proposed Statement. The Board believes that the acquisition method better reflects the economic substance of mergers and acquisitions by not-for-profit organizations and better meets the objectives of financial reporting of those transactions by not-for-profit organizations.

Reflects the economic substance of the transaction

B26. In developing this proposed Statement, the Board concluded that the acquisition method is the appropriate method of accounting for all mergers and acquisitions for which the economic substance is an acquisition of the net assets of a business or nonprofit activity by a controlling or surviving organization. The Board observed that not-for-profit organizations merge or acquire for many of the same reasons as business entities. Those reasons include reducing costs through economies of scale, expanding existing product or service offerings into new markets, and expanding the range of product or service offerings available to existing customers. Additionally, many mergers and acquisitions by not-for-profit organizations take forms similar to those used in business combinations. Examples of those forms are included in paragraph 5 of this proposed Statement.

B27. In developing Statement 141, the Board considered whether any business combinations are **not** acquisitions and, if so, whether a method other than the acquisition method should be used to account for them. Paragraph B42 of Statement 141 states:

> The Board concluded that "true mergers" or "mergers of equals" are nonexistent or so rare as to be virtually nonexistent, and many respondents agreed. Other respondents stated that even if a true merger or merger of equals did occur, it would be so rare that a separate accounting treatment is not warranted. They also stated that developing the criteria necessary to

> identify those transactions simply would be a continuation of the same problems and potential for abuse evidenced by Opinion 16. . . . The Board further observed that respondents and other constituents were unable to suggest an unambiguous and nonarbitrary boundary for distinguishing true mergers or mergers of equals from other two-party business combinations and concluded that developing such an operational boundary would not be feasible. Moreover, even if those mergers could feasibly be distinguished from other combinations, the Board concluded that it does not follow that such combinations should be accounted for on a carry-over basis. If they were to be accounted for using a method other than the purchase method, the Board believes that a better method would be the fresh-start method.

B28. The Board affirmed those conclusions in this proposed Statement and concluded that, generally, the economic substance of the merger or acquisition by a not-for-profit organization is that one organization acquires an integrated group of assets (by purchase or by gift). Therefore, because those transactions are generally acquisitions and because those that are not acquisitions cannot be distinguished using an unambiguous basis, all mergers and acquisitions by not-for-profit organizations should be accounted for using the acquisition method.

Better meets the objectives of financial reporting

B29. In developing this proposed Statement, the Board considered whether the acquisition method produces information that better meets the objectives of financial reporting by not-for-profit organizations, especially those objectives that are different from business entities. The Board concluded that the acquisition method better meets those objectives. As described in FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*, many of the objectives of financial reporting by not-for-profit organizations are the same as those for business entities. However, because not-for-profit organizations have different resource providers than business entities, those objectives differ in some respects.

B30. Donors provide resources for fundamentally different reasons than do investors and creditors and make resource allocation decisions based on different considerations. However, whether the resource provider is an investor, creditor, or donor, the information that financial reporting should provide for its allocation decisions contains a universal aspect—information that enables them to assess an entity's cash-generating abilities and cash flow potential. The information provided by the acquisition method is more useful to assess cash-generating abilities than the information provided by the pooling method. Paragraph B44 of Statement 141 states:

> The Board noted that neither the cash-generating abilities of the combined entity nor its future cash flows generally are affected by the method used to account for the combination. However, fair values reflect the expected cash flows associated with acquired assets and assumed liabilities. Because the pooling method records the net assets acquired at their carrying amounts rather than at their fair values, the information that

> the pooling method provides about the cash-generating abilities of those net assets is less useful than that provided by other methods.

B31. Present and potential donors also need decision-useful information with which to assess the organization's ability to continue the mission and services of the consolidated organization. As with business entities, measuring and recognizing the identifiable assets acquired and liabilities assumed in a merger or acquisition at their acquisition date fair values would provide more useful information for assessing the cash flow potential and the cash needed to satisfy obligations. For those reasons, both the acquisition method and the fresh-start method would produce more decision-useful information to donors and other resource providers of not-for-profit organizations than does the pooling method.

B32. Another objective of financial reporting is to provide information for the measurement of efforts and accomplishments of the entity. To satisfy those goals, somewhat different information is required for not-for-profit organizations as compared to business entities. Not-for-profit organizations have a greater need for information about the service efforts and accomplishments of an entity, because of the lack of earnings as a focal measure. Resource providers expect a not-for-profit organization's governing body "to make operating cost/benefit judgments that achieve the objectives of the organizations with minimum use of resources" (Concepts Statement 4, paragraph 40). Thus, donors need information about changes in the amount and nature of an organization's net resources and information about service efforts and accomplishments rather than measures of earnings.

B33. Paragraphs 52 and 53 of Concepts Statement 4 state:

> Financial reporting should provide information about the service efforts of a [not-for-profit] organization. Information about service efforts should focus on how the organization's resources (inputs such as money, personnel, and materials) are used in providing different programs or services. Techniques for measuring the costs of significant programs or services are well developed and this information normally should be included in financial statements.
>
> Ideally, financial reporting also should provide information about the service accomplishments of a [not-for-profit] organization. Information about service accomplishments in terms of goods or services produced (outputs) and of program results may enhance significantly the value of information provided about service efforts. However, the ability to measure service accomplishments, particularly program results, is generally undeveloped. [Footnote reference omitted.]

The Board noted that because the techniques employed to measure the costs and the service accomplishments of a not-for-profit organization are underdeveloped, this objective is not a determining factor in deciding which method should be used to account for a merger or acquisition.

Reasons for Rejecting the Pooling Method

B34. The requirements of the pooling method are described in paragraph F1 of Statement 141 as follows:

> . . . the carrying amount of assets and liabilities recognized in the statements of financial position of each combining entity are carried forward to the statement of financial position of the combined entity. No other assets or liabilities are recognized as a result of the combination, and thus the excess of the purchase price over the book value of the net assets acquired (the purchase premium) is not recognized. The income statement [or statement of activities] of the combined entity for the year of the combination is presented as if the entities had been combined for the full year; all comparative financial statements are presented as if the entities had previously been combined.

B35. The Board rejected the use of the pooling method for accounting for mergers and acquisitions by not-for-profit organizations. The primary reasons for the Board's conclusion include:

a. **Mergers and acquisitions are economically similar.** Paragraph B39 of Statement 141 states:

> The Board noted that mergers are not transactions between owners as asserted by proponents of the pooling method, but rather that the combining entities themselves are deeply involved in those transactions. . . . The net assets of one entity are transferred to another, . . . and that transaction should be accounted for on the same basis that would be used to record an investment by owners in the form of cash—that is, on a fair value basis.

b. **The information provided by the pooling method is less decision useful.** Users of the financial statements of not-for-profit organizations need information to assess the cash flow potential to provide future services and the cash needed to satisfy obligations. That information is useful because it helps a resource provider "identify the organization's financial strengths and weaknesses, evaluate information about the organization's performance . . . , and assess its ability to continue to render services" (Concepts Statement 4, paragraph 44). Additionally, that information "provides direct indications of the cash flow potential of some resources and of the cash needed to satisfy many, if not most, obligations. The assessment of cash flow potential is important because it relates directly to the organization's ability to provide the goods and services for which it exists" (Concepts Statement 4, paragraph 45). The acquisition method would provide better information with which to make that assessment as compared with the information provided by the pooling method.

c. **The pooling method is inconsistent with accounting for other contributions received.** In some mergers and acquisitions by not-for-profit organizations, no consideration is transferred in exchange for the acquiree (or the consideration transferred is significantly less than the net assets of the acquiree). In those circumstances, the acquirer receives all, or a portion of, the net assets of the acquiree as a contribution. FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, requires that contributions be recognized and measured at their fair values. The pooling method is inconsistent with Statement 116 because it requires that assets acquired and liabilities assumed be recognized at the acquiree's carrying basis. Additionally, the pooling method does not require the acquirer to recognize all assets and liabilities. Only those assets and liabilities that are recognized by the acquiree are recognized by the acquirer. In contrast, Statement 116 generally requires the recognition of contributed assets received, including those that may not be recognized by the donor, such as certain intangible assets.

d. **The pooling method is inconsistent with accounting for other exchange transactions.** While many mergers and acquisitions by not-for-profit organizations occur in the form of a gift, some mergers and acquisitions by not-for-profit organizations are exchanges. Paragraph B57 of Statement 141 states:

> The Board observed that the pooling method is an exception to the general concept that exchange transactions are accounted for in terms of the fair values of the items exchanged. Because the pooling method records the combination in terms of the carrying amounts of the parties to the transaction, it fails to record the investment made in the combination and fails to hold management accountable for that investment and its subsequent performance.

Interaction between communities and questions about common control of merging not-for-profit organizations

B36. Paragraphs A94–A100 of this proposed Statement retain guidance for a merger or acquisition between entities under common control. That guidance would require accounting that is similar to the pooling method for transfers of net assets between entities under common control. Some resource group members suggested that mergers and acquisitions by not-for-profit organizations should also retain the use of the pooling method because the community (a group of citizens) or public (state) owns all not-for-profit organizations. As evidence of community ownership, supporters of this view identified laws that restrict the distribution of the assets of a not-for-profit organization and oversight by the state attorney general of a not-for-profit organization's activities. Those laws prohibit private use and include oversight of an organization's ability to merge, combine with, or sell its assets to another entity.

B37. The Board acknowledges that each state has established laws to ensure that the assets remain in the public sector for charitable, religious, or other public purposes.

However, the Board does not believe those laws result in community ownership of an organization. An organization is controlled by the vote of its governing board, not by the vote of the community. Further, the primary purpose of actions taken by a state attorney general is to protect the interests of contributing donors and members who would otherwise have no practical means of monitoring an organization's activities or actions of its governing board. Those actions may also have an indirect effect of protecting community interests, but that is not the equivalent of community ownership or control. The Board concluded that:

a. A community's relationship with a not-for-profit organization should have no effect on the accounting for mergers and acquisitions by a not-for-profit organization.
b. The pooling method should be rejected for all mergers and acquisitions by a not-for-profit organization within the scope of this proposed Statement.

Reasons for Rejecting the Fresh-Start Method

B38. Under the fresh-start method, the assets and liabilities of the combining entities (regardless of whether they had been recognized in the statements of financial position of those entities) are recognized in the statement of financial position of the combined entity at fair value. The combined entity is treated as a new entity as of the date of the combination and its history commences on that date. As with the purchase method, the fresh-start method can be applied to business combinations that are effected by cash, other assets, debt, equity shares, or a combination thereof.

B39. In developing this proposed Statement, the Board studied transactions that some might describe as "true mergers" or "mergers of equals." At an open educational meeting with members of the FASB's resource group, some members expressed concerns about the difficulties in identifying the acquirer in certain mergers by not-for-profit organizations. The Board considered examples of mergers and acquisitions and agreed that it is difficult to identify the acquirer in certain transactions. However, for reasons that are similar to those in Statement 141, the Board also rejected the application of the fresh-start method for accounting for two-party mergers and acquisitions in which an acquirer cannot be identified.

B40. The Board acknowledged that the application of the fresh-start method in those "true merger" circumstances would be a more faithful representation, which would increase the benefits to users of the financial statements. However, the Board concluded that those benefits outweigh the disadvantages of creating and maintaining two different methods of accounting and the potential cost of constant revaluation for those organizations that undergo a series of mergers. The Board's main concern about using two methods is the difficulty of drawing unambiguous and nonarbitrary boundaries between circumstances in which the acquisition method or the fresh-start method should be applied. Additionally, the Board was concerned that requiring two methods of accounting could maintain a potential for accounting arbitrage.

Fundamental Principles

B41. In this proposed Statement, like proposed Statement 141(R), the Board sought to develop the fundamental principles for the accounting and reporting of mergers and acquisitions by not-for-profit organizations and to consistently use those principles to develop this proposed Statement's requirements. Those principles are directed at faithfully reflecting the underlying economic circumstances of those transactions and events. This proposed Statement's fundamental principles create a foundation for its objectives and requirements. The fundamental principles of this proposed Statement are that:

a. **The assets acquired and liabilities assumed in a merger or acquisition by a not-for-profit organization should be recognized at their fair values as of the date control is obtained.** The Board concluded that recognizing assets acquired and liabilities assumed is consistent with the objective of faithfully reflecting the underlying economics.
b. **Those assets acquired and liabilities assumed should be measured at their fair values as of the date control is obtained.** The Board concluded that measuring those assets acquired and liabilities assumed at their acquisition date fair values also is consistent with the objective of faithfully reflecting the underlying economics.
c. **In concept, the total amount to be recognized for the acquiree should be the fair value of the acquiree as a whole. Also, in concept, contributions received should be recognized at their fair values as revenues or gains in the period received and recognized as assets, decreases of liabilities, or expenses depending on the form of the benefits received.** Unlike proposed Statement 141(R), the Board concluded that mergers and acquisitions by not-for-profit organizations cannot be presumed to be exchanges of equal values because those transactions may involve a contribution. Therefore, for cost-benefit reasons (discussed in paragraphs B20–B23) the Board concluded that the total amount to be recognized, which is used to calculate goodwill or the contribution received, should be the net assets of the acquiree and any consideration exchanged for the acquiree.

Commonality with the Principles of Other Transactions

B42. There is commonality between the underlying economics and the principles in this proposed Statement and the principles for accounting for asset exchanges, business combinations by business entities, and contributions received. Principles (a) and (b) in paragraph B41 are consistent with the fundamental principles for asset exchanges. Asset acquisitions generally are measured on the basis of the values exchanged. Measurement of the values exchanged is based on the fair value of the consideration given or the fair value of the net assets acquired, whichever is more readily measurable. The Board observed that those basic principles also are consistent with the general concepts acknowledged in APB Opinion No. 29, *Accounting for Nonmonetary Transactions.* Paragraph 18 of Opinion 29 states that:

> . . . in general accounting for nonmonetary transactions should be based on the fair values of the assets (or services) involved which is the same basis as that used in monetary transactions. Thus, the cost [initial basis] of a nonmonetary asset acquired in exchange for another nonmonetary asset is the fair value of the asset surrendered to obtain it, and a gain or loss should be recognized on the exchange. **The fair value of the asset received should be used to measure the cost [initial basis] if it is more clearly evident than the fair value of the asset surrendered. Similarly, a nonmonetary asset received in a nonreciprocal transfer should be recorded at the fair value of the asset received.** [Emphasis added; footnote reference omitted.]

B43. Principles (a)–(c) in paragraph B41 are also consistent with the basic principles for business combinations by business entities. In developing this proposed Statement, the Board considered whether the principles developed in the project on business combinations apply to mergers and acquisitions by not-for-profit organizations. The Board concluded that the same fundamental principles in proposed Statement 141(R) apply to not-for-profit organizations with one exception: it cannot be presumed that mergers and acquisitions by those organizations that serve a public interest are necessarily exchange transactions in which willing parties are presumed to exchange equal values. In business combinations, there is a presumption that those combinations "generally are exchange transactions in which knowledgeable, unrelated willing parties are presumed to exchange equal values" (paragraph B23(d) of proposed Statement 141(R)). In contrast, mergers and acquisitions by not-for-profit organizations may involve no consideration transferred in exchange for the acquiree or involve consideration transferred that is substantially lower than the value of the net assets of the acquiree. Those mergers and acquisitions involve contributions received by the acquirer rather than exchanges.

B44. Principle (c)—accounting for contributions received—in paragraph B41 is also generally consistent with the basic principles for recognizing and measuring contributions in Statement 116. Specifically, Statement 116 requires and this proposed Statement would require the recognition of contributions received as assets (or reductions of liabilities). Also, Statement 116 requires and this proposed Statement would require that the relevant attribute for measuring contributions received is fair value. The Board concluded that contributions received in a merger or acquisition by a not-for-profit organization should be recognized in accordance with Statement 116. In a merger or acquisition, an acquirer may receive a contribution of either an entire or part of a business or nonprofit activity. Paragraph 3 of Statement 116 describes these inherent contributions:

> . . . 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, the contribution inherent in that transaction is within the scope of this Statement.

For cost-benefit reasons, the Board concluded that rather than measure the fair value of the business or nonprofit activity, the contribution received should be based on the net assets received and any consideration transferred in exchange for the acquiree.

Departures from This Proposed Statement's Principles and the Reasons for Those Departures

B45. The Board considered the benefits and costs of this proposed Statement's provisions, including consideration of whether any exceptions to its principles are necessary to reduce the costs of application without significantly reducing the expected benefits. The Board concluded that exceptions should be made in this proposed Statement to the requirements to measure the acquisition date fair value of the acquiree and to measure and recognize certain identifiable assets acquired and liabilities assumed at their acquisition date fair values. The exception to the requirement to measure the acquisition date fair value of the acquiree would be unique to mergers and acquisitions by not-for-profit organizations and would not be a broad exception in proposed Statement 141(R). The latter exceptions for certain identifiable assets acquired and liabilities assumed (for example, deferred taxes, pensions, and other postemployment benefits) would be similar to the exceptions made in proposed Statement 141(R). Those exceptions were made for the same reasons as those given in proposed Statement 141(R) and are discussed further in paragraphs B80–B89 and B93–B102.

Definition of a Merger or Acquisition by a Not-for-Profit Organization

B46. This proposed Statement would apply to not-for-profit organizations, as defined in paragraph 4(o). As observed in paragraph B19, the types of not-for-profit organizations are disparate. In developing this proposed Statement's definition of a merger or acquisition by a not-for-profit organization, the Board considered the definition of a business combination in paragraph 3(e) of proposed Statement 141(R): "a transaction or other event in which an acquirer obtains control of one or more businesses." The Board concluded in that proposed Statement that all changes of control in which an entity acquires a business are economically similar transactions or events.

B47. The meaning of *control* in proposed Statement 141(R) is based on voting rights, which is consistent with Accounting Research Bulletin No. 51, *Consolidated Financial Statements.* The Board concluded that that definition of control is insufficient for not-for-profit organizations. Therefore, the Board considered whether the scope of this proposed Statement should be based on the proposed consolidation requirements in the February 1999 FASB Exposure Draft, *Consolidated Financial Statements: Purpose and Policy,* or based on the existing requirements in AICPA SOP 94-3, *Reporting of Related Entities by Not-for-Profit Organizations,* and the health care Guide.

B48. The Board observed that the AICPA guidance requires that an organization must have control of another entity to consolidate that entity. However, some entities that control other organizations are not necessarily required to consolidate those organizations. The guidance in SOP 94-3 and the health care Guide:

a. Requires an organization to consolidate another organization if it has a controlling financial interest in another not-for-profit organization. However, it prohibits consolidation if control does not rest with the majority owner.
b. Requires an organization to consolidate another organization if it has a controlling ownership interest in another organization (or a controlling voting

interest in its board) and if the organization also has an economic interest in that other organization. However, it prohibits consolidation if control is likely to be temporary or does not rest with the majority owner.

c. Permits an organization to consolidate another organization if it has a controlling economic interest other than a majority ownership or voting interest, such as control through contract or affiliation agreement. However, it prohibits consolidation if control is likely to be temporary.

B49. The Board concluded that the meaning of control should be based on the existing requirements because refining or defining control is beyond the scope of this project. That conclusion also is consistent with the Board's approach in FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*, which requires an organization to use existing definitions of control in determining whether a transfer should be accounted for as an asset by the resource provider and as a liability by the recipient organization.

B50. The Board concluded that all initial consolidation events in which an organization acquires a business or nonprofit activity are economically similar transactions or events that should be accounted for similarly. The Board decided that the guidance in this proposed Statement should be consistent with the existing consolidation policy for not-for-profit organizations provided by other accounting guidance. The term *control* is not defined in this proposed Statement. The Board decided that the accounting and reporting requirements in this proposed Statement should apply to any event that results in the initial inclusion of a business or nonprofit activity in a not-for-profit organization's financial statements. That requirement would apply to an acquisition of a business or nonprofit activity that is not a separate entity and also would apply to all initial consolidation events, which is consistent with existing consolidation accounting guidance for not-for-profit organizations.

Definition of a Business or Nonprofit Activity

B51. Paragraph 5 of this proposed Statement notes that "a merger or acquisition is any transaction or other event that results in a not-for-profit organization initially recognizing **a business or nonprofit activity** in its financial statements" (emphasis added). The Board decided to use the terms *business* and *nonprofit activity* to differentiate acquisitions of a group of assets from an integrated set of assets and activities that are within the scope of this proposed Statement.

B52. In developing this Statement's definitions of a business and a nonprofit activity, the Board considered the definition of a business in paragraph 3(d) of proposed Statement 141(R):

> . . . an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing either:
>
> (1) A return to investors

(2) Dividends, lower costs, or other economic benefits directly and proportionately to owners, members, or participants.

B53. The Board decided to define a *business* and a *nonprofit activity* similar to the revised definition of a business in proposed Statement 141(R), but added characteristics to make the definition of a *nonprofit activity* applicable to additional circumstances that apply to not-for-profit organizations. A *business* is defined in this proposed Statement as:

> . . . an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing economic benefits in the form of a return to investors. Those returns are reflected in the market price of the equity interests or through dividends or through other forms, such as lower costs that are provided directly and proportionately to owners, members, or participants. A business often is, but need not be, a separate legal entity. [paragraph 4(d)]

B54. A *nonprofit activity* is defined in this proposed Statement as:

> . . . 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. [paragraph 4(p)]

Thus, the term *nonprofit activity*, as defined, is sufficiently broad to encompass sets of activities and assets that have similar capabilities as a business but may be conducted for somewhat different purposes, such as to fulfill its purpose or mission.

Scope and Transactions That Are Not Mergers or Acquisitions

B55. This proposed Statement, like proposed Statement 141(R), would exclude the formation of a joint venture and mergers or acquisitions involving businesses, nonprofit activities, or entities that are under common control. Paragraph B42 of proposed Statement 141(R) explains that the Board:

> . . . decided to continue to exclude from the scope of this Statement and its definition of a business combination (a) the formation of a joint venture and (b) combinations involving entities or businesses that are under common control. The Board is not aware of developments since the issuance of Statement 141 that suggest that issues surrounding the accounting for those events, which do not involve an acquirer obtaining control of an acquiree, need to be addressed prior to issuing this Statement. Rather, the Board continues to believe that those issues should be addressed in future projects that address whether, and, if so, when to apply a new basis of accounting.

B56. For the same reasons that are in proposed Statement 141(R), the Board decided to limit the scope of this proposed Statement to acquisitions of asset groups that make up a business or nonprofit activity. As indicated in paragraph B39 of proposed Statement 141(R):

> Some Board members indicated that they believe that the guidance in [proposed] Statement [141(R)] is appropriate for all asset acquisition transactions and expressed a preference for expanding the scope of [that] Statement to acquisitions of asset groups. They noted that doing so would avoid the need to distinguish between those groups that are businesses and those that are not. However, other Board members noted that broadening the scope of [that] Statement beyond acquisitions of businesses would require further research and deliberation of additional issues and delay the implementation of [that] Statement's improvements to practice. The Board agreed and decided not to extend the scope of [that] Statement to acquisitions of all asset groups.

Application of the Acquisition Method

B57. Paragraph 1 of this proposed Statement includes recognition and measurement aspects of the objective of this proposed Statement. Consistent with that objective, paragraph 8 of this proposed Statement identifies four steps in applying the acquisition method of accounting for a merger or acquisition by a not-for-profit organization:

a. Identify the acquirer.
b. Determine the acquisition date.
c. Recognize and measure the identifiable assets acquired and the liabilities assumed.
d. Recognize and measure either goodwill acquired or a contribution received.

Identifying the Acquirer

B58. Paragraph 9 of this proposed Statement requires identification of an acquirer in every merger or acquisition by a not-for-profit organization, which is consistent with the requirements for business entities in paragraph 10 of proposed Statement 141(R). The objective of identifying the acquirer is to identify which entity is the continuing reporting entity. In developing the guidance for determining which entity is the acquirer, the Board considered the indicators that are in Statement 141 and proposed Statement 141(R).

B59. As in Statement 141 and proposed Statement 141(R), the Board decided to provide additional guidance that describes some of the indicators that may be useful in determining the acquiring organization. In developing those indicators, the Board concluded that the indicators that had been identified for business entities in Statement 141 generally also should apply to not-for-profit organizations. The decision-making powers of control are generally held by an organization's governing body rather than equity holders. Therefore, indicators that involve exchanges of equity securities often are not applicable to not-for-profit organizations because those types of exchanges generally are not present in mergers and acquisitions by those organizations.

B60. The Board also identified an additional indicator that may be particularly useful for determining which organization is the acquirer—the organization's governing body. That indicator may provide strong evidence of the identity of the acquirer, particularly if one of the organizations has the ability to select or to dominate the process of selecting a voting majority of the organization's governing body. To increase the consistent application by organizations that consider that indicator, the Board decided to provide factors to consider in determining which organization is able to select or to dominate the process of selecting the governing body of the organization. Because mergers and acquisitions can be structured in many different ways and not-for-profit organizations can be governed under different structures, the Board rejected prioritizing the guidance in paragraph 11 of this proposed Statement. Rather, this proposed Statement would require the use of preparer and auditor judgment for identifying the acquirer.

Determining the Acquisition Date

B61. The Board decided that the acquisition date for mergers and acquisitions by not-for-profit organizations is the date that the acquirer obtains control of the acquiree. That requirement is consistent with the requirements for business entities in proposed Statement 141(R) and precludes the acquirer from designating a date other than the acquisition date to account for the merger or acquisition. As noted in paragraph B55 of proposed Statement 141(R):

> The Board concluded that to faithfully represent an acquirer's financial position and results of operations, the acquirer should account for all business combinations at the acquisition date. That is, its financial position should reflect the assets acquired and liabilities assumed at the acquisition date—not before they are obtained or assumed. Moreover, the acquirer's financial statements for the period should include only the cash inflows and outflows, revenues and expenses, and other effects of the acquiree's operations after the acquisition date.

Identifying, Recognizing, and Measuring the Identifiable Assets Acquired and the Liabilities Assumed

B62. The fundamental principles in this proposed Statement focus on the appropriate recognition and measurement of the assets acquired and liabilities assumed in a merger or acquisition. The Board believes that consistent application of those principles will improve the completeness, reliability, and relevance of the information that is reported in an acquirer's financial statements. However, for cost-benefit reasons and to minimize disruptions to practice, this proposed Statement would retain existing GAAP by providing certain accommodations that are exceptions to those principles. Those exceptions would be for:

a. Assets and liabilities that Statement 116 requires not be recognized. Statement 116, as would be amended by paragraph E5 of this proposed Statement, would require that certain collection items and contributed services not be recognized in the financial statements. Additionally, Statement 116 delays the recognition of assets and liabilities associated with conditional promises made until those conditions are substantially met. This proposed Statement would retain the same requirements as Statement 116 (see paragraphs B81–B88).

b. Assets and liabilities that proposed Statement 141(R) would require to be measured at an amount other than fair value or assets that proposed Statement 141(R) would require not to be separately recognized apart from goodwill. Those exceptions are for goodwill (see paragraphs B119–B155), operating leases, assembled workforce, assets held for sale, deferred taxes, and certain employee benefit plans.

Recognition principle

B63. The Board decided that, in principle, an acquirer should recognize the identifiable assets acquired and liabilities assumed. Paragraph B104 of proposed Statement 141(R) observes that the application of the recognition principle will improve the relevance and comparability of the information provided. Applying the principle also would:

a. Give rise to the recognition of assets acquired and liabilities assumed that may not have been recognized in the financial statements of the acquiree before the merger or acquisition. For example, an acquirer would be required to recognize intangible assets, such as donor lists, and liabilities that arise from contingencies. Those assets and liabilities may not have been recognized in the acquiree's statement of position before the acquisition.

b. Eliminate the practice of recognizing particular items **as if** they were assets acquired or liabilities assumed at the acquisition date even though they did not meet the definition of an asset or a liability. For example, as discussed in paragraph B108 of proposed Statement 141(R), ". . . some future costs that an acquirer expected to incur often were viewed as a cost of the acquiree and recognized *as if* they were a liability at the acquisition date."

B64. The Board decided that this proposed Statement should emphasize three fundamental conditions in recognizing an item as part of the acquirer's accounting, which are consistent with those in Statement 141(R). Those conditions are that:

a. The item acquired or assumed must be an asset or liability at the acquisition date.

b. If the item is an intangible asset, it must be separable from goodwill at the acquisition date.

c. The item acquired or assumed must be part of the acquiree that the acquirer receives for the consideration transferred in exchange for that business or nonprofit activity. That is, the items are not other assets acquired or liabilities assumed as part of a substantively separate exchange transaction or as part of a substantively separate contribution transaction.

To achieve a reasonably high degree of consistency in practice and to resolve existing inconsistencies, the Board affirmed that this proposed Statement should provide the same guidance as proposed Statement 141(R) for applying its recognition principles.

Asset and liability definition

B65. The Board concluded that for purposes of determining whether an item is an asset or liability, this proposed Statement should use the definitions in FASB Concepts Statement No. 6, *Elements of Financial Statements.* Paragraphs 25 and 35 of Concepts Statement 6 defines those elements as:

> Assets are probable[18] future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
>
> Liabilities are probable[21] future sacrifices of economic benefits arising from present obligations[22] of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
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> ---
>
> [18 and 21] *Probable* is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, *Accounting for Contingencies,* par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved (*Webster's New World Dictionary of the American Language,* 2d college ed. [New York Simon and Schuster 1982], p. 1132). Its inclusion in the definition is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain (pars. 44–48).
>
> [22] *Obligations* in the definition is broader than *legal obligations*. It is used with its usual general meaning to refer to duties imposed legally or socially; to that which one is bound to do by contract, promise, moral responsibility, and so forth (*Webster's New World Dictionary,* p. 981). It includes equitable and constructive obligations as well as legal obligations (pars. 37–40).

Therefore, in principle, this proposed Statement would require an acquirer to recognize in its financial statements all items that meet those definitions of an asset and a liability that are acquired or assumed as part of the merger or acquisition.

Acquired intangible assets that are separable from goodwill

B66. This proposed Statement would require the acquirer to recognize separately from goodwill the acquisition date fair value of **identifiable** intangible assets acquired in a merger or acquisition. Paragraph 17 of this Statement states that "an intangible asset is identifiable if it arises from contractual or other legal rights (the contractual-legal criterion) or is separable (separability criterion)." Those requirements are consistent with the explicit criteria for determining whether an intangible asset should be recognized apart from goodwill in Statement 141. The Board concluded that it should provide that same explicit criteria in this proposed Statement for the same reasons. Paragraph B148 of Statement 141 states that "intangible assets acquired in a business combination [accounted for under Opinion 16] often were included in the amount recognized as goodwill, despite the provisions in [that Opinion] that required they be recognized apart from goodwill." The Board decided to separate intangible assets from goodwill to enhance the decision usefulness of financial statements. Specifically, the separate recognition of intangible assets and separating finite-lived assets from indefinite-lived assets would allow for subsequent treatment (amortization or impairment) that is more consistent with the wasting or nonwasting nature of those assets.

B67. Consistent with paragraphs A9 and A10 of this proposed Statement, an intangible asset would be identifiable if either:

a. It arises from contractual or other legal rights, regardless of whether it is separable from the entity (the contractual-legal criterion); or
b. It is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged (regardless of whether there is an intent to do so) either individually or in combination with a related contract, asset, or liability (the separability criterion).

B68. Those requirements and criteria for determining whether an intangible asset is identifiable are consistent with, and were developed in, Statement 141. The Board's consideration of those criteria is included in paragraphs B69–B76. In this proposed Statement, the Board also considered intangible assets that are particularly relevant to not-for-profit organizations—donor-related intangible assets. The Board's consideration of the separate recognition of those assets is included in paragraphs B105–B108.

B69. In this proposed Statement, the Board concluded that the fact that an intangible asset arises from contractual or other legal rights is an important characteristic that distinguishes many intangible assets from goodwill. Paragraph B156 of Statement 141 states:

> In considering alternative recognition criteria, the Board observed that in contrast to goodwill, the values of many intangible assets arise from rights conveyed legally by contract, statute, or similar means. . . . In contrast, the value of goodwill arises from the collection of assembled assets that make up an acquired entity or the value created by assembling a collection of assets through a business combination, such as the synergies that are expected to result from combining one or more businesses.

B70. Consensuses that were reached in EITF Issue No. 02-17, "Recognition of Customer Relationship Intangible Assets Acquired in a Business Combination," further clarifies the application of the contractual-legal criterion by requiring that:

a. Regardless of whether a contract is in existence at the acquisition date, if an entity establishes a relationship with its customers through contracts, that customer relationship arises from contractual rights.
b. If an entity had a customer relationship with customers through an order or a production backlog arising from contracts (such as purchase or sales orders), that customer relationship arises from contractual rights and, therefore, meets the contractual-legal criterion.

B71. Consistent with the guidance for business entities, the Board concluded that this proposed Statement should include the same requirements and application guidance for not-for-profit acquirers.

B72. In developing Statement 141, the Board also observed a second characteristic that distinguishes goodwill from other intangible assets. That characteristic is that some intangible assets are capable of being separated from the acquiree—either individually or as part of a group of related assets or liabilities—and exchanged for value. Other intangible assets, like goodwill, cannot be separated from an acquiree and sold or otherwise transferred.

B73. In this proposed Statement, the Board concluded that the fact that an intangible asset can be separated from the acquiree is another characteristic that distinguishes goodwill from other intangible assets. Therefore, consistent with the guidance for acquirers that are business entities, this proposed Statement includes the same requirements and application guidance for not-for-profit acquirers.

B74. In developing Statement 141, the Board rejected the following suggested alternatives to its separability criterion:

a. Limit the separability criterion to intangible assets that are separable **and that trade in observable exchange transactions.** The Board rejected that suggestion because those transactions are not necessarily the only evidence of separability. Rather, those transactions are one source that could provide evidence of an intangible asset's separability.
b. Modify the separability criterion to require recognition of an intangible asset apart from goodwill **only if** management of the entity intends to sell, lease, or otherwise exchange the asset. The Board rejected that suggestion because the characteristic that distinguishes goodwill from other intangible assets is the asset's **capability** of being separated from the acquiree and exchanged for value. The **intent** to sell or otherwise exchange the asset is not the relevant distinguishing characteristic between goodwill and other intangible assets.

B75. In this proposed Statement, the Board concluded that the requirements and criteria for determining whether an intangible asset should be recognized apart from goodwill should be the same as Statement 141, including the clarifications in proposed Statement 141(R). In developing those criteria for intangible assets in Statement 141, the Board considered comments from respondents to both the 1999 Exposure Draft and the 2001 Exposure Draft. The Board rejected the following suggestions to:

a. Eliminate the requirement to recognize intangible assets apart from goodwill or include all intangible assets with characteristics similar to goodwill in the amount recorded as goodwill.
b. Recognize only (apart from goodwill) intangible assets that have direct cash flows and those that are bought and sold in observable exchange transactions.
c. State that an item is not an asset if it is not separable.

B76. In this proposed Statement, like Statement 141, the Board rejected those suggested alternatives. See paragraphs B162–B164 of Statement 141 for further information about the Board's reasons for rejecting those suggestions.

Determining that assets acquired and liabilities assumed are part of the merger or acquisition

B77. To recognize an asset or liability as part of the acquirer's accounting for the merger or acquisition, the asset or liability must be part of the exchange for the acquiree or part of the contributed business or nonprofit activity. Paragraph 58 of this proposed Statement states:

> An acquirer shall assess whether any portion of the consideration transferred (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the merger or acquisition. Only the consideration transferred for the acquiree and the assets acquired or liabilities assumed or incurred that are part of the merger or acquisition shall be included in the acquisition accounting. Any portion of the consideration transferred or any assets acquired or liabilities assumed or incurred that are not part of the merger or acquisition shall be accounted for separately.

B78. An objective of that assessment is to distinguish exchanges or contributions that are part of the merger or acquisition from exchanges that are for other assets or from contributions that are for other purposes. To assist in meeting that objective, paragraph 60 of this proposed Statement includes four specific examples of payments or other arrangements that are not part of the merger or acquisition. Three of those examples are included in proposed Statement 141(R). The Board decided to include a fourth example that is relevant to circumstances generally involving not-for-profit organizations.

B79. The Board also decided to provide guidance to assist organizations in distinguishing between the elements of a merger or acquisition and other concurrent transactions. Guidance in paragraphs 59 and A63–A73 of this proposed Statement includes three factors to be considered in assessing a business combination transaction:

a. The reason for the transaction or event
b. The identity of who initiated the transaction or event
c. The timing of the transaction or event.

The Board believes that although those factors are neither mutually exclusive nor individually conclusive, they can be helpful in considering whether a transaction or event is arranged primarily for the economic benefit of the acquirer or combined entity.

Exceptions to the recognition principle

B80. The Board decided to allow certain exceptions to the application of this proposed Statement's principle of recognizing the identifiable acquired assets and assumed liabilities, primarily because of cost-benefit or practicability concerns. The reasons for allowing those exceptions are described in more detail in paragraphs B81–B89.

Certain collection items

B81. Paragraph 25 of this proposed Statement requires the acquirer to apply the guidance in Statement 116 to account for collections that are contributed to or purchased as part of the merger or acquisition. This proposed Statement defines and uses the term *collections* consistent with its meaning in Statement 116. For contributed collections, paragraph 11 of Statement 116 states:

> An entity need not recognize contributions of works of art, historical treasures, and similar assets if the donated items are added to collections that meet all of the following conditions:
>
> a. Are held for public exhibition, education, or research in furtherance of public service rather than financial gain
> b. Are protected, kept unencumbered, cared for, and preserved
> c. Are subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

B82. The Board provided an exception to the recognition principle in this proposed Statement for collection items that are acquired in a merger or acquisition by an acquirer that has an organizational policy not to capitalize collections. That exception is to account for those items in accordance with Statement 116, rather than the recognition requirements of this proposed Statement. The Board concluded that the cost to measure separately the fair value of the collection items will, in many circumstances, exceed the incremental benefits of the information gained. In reaching that conclusion, the Board observed that accounting for collections was an area that was deliberated by the Board in reaching its conclusions in Statement 116. In Statement 116, the Board concluded that works of art, historical treasures, and similar items are **assets.** However, for cost-benefit reasons, Statement 116 permits nonrecognition of assets under certain specific circumstances for works of art, historical treasures, and similar items held as part of a collection. Although capitalization of collections was permitted upon the initial adoption of Statement 116 (either retrospectively or prospectively), most organizations that have collections do not currently capitalize them. Therefore, requiring recognition of collection items acquired in a merger or acquisition would be inconsistent with Statement 116 and would be of limited use because the recognized collection would only include those newly acquired assets.

B83. Consistent with Statement 116, under paragraph 25 of this proposed Statement, an acquirer that has an organizational policy should not capitalize its collections. The acquirer should:

a. Not recognize a collection item as an asset.
b. Recognize the cost of the purchased collection items as a decrease in the appropriate class of net assets in the statement of activities.

This proposed Statement also would require an acquirer that capitalizes its collections to recognize the acquisition date fair value of contributions or purchases of a work of art, historical treasure, or similar assets as an acquired asset.

B84. The Board's objective and approach in this proposed Statement are to retain consistency with the existing guidance for collections. As part of a merger or acquisition, collection items that are added to the acquirer's inexhaustible collection may also be purchased. Paragraph 141 of Statement 116 contains an illustration for an organization that does not capitalize collections. In that example, the organization reports its purchases of collection items as a decrease to its net assets in the statement of activities. Therefore, the Board concluded that collections that are purchased as part of a merger or acquisition should be included as part of the acquisition accounting. However, consistent with Statement 116, if the acquirer's organizational policy is not to capitalize its collections, the acquisition date fair value of purchased collections should be recognized as a decrease in the appropriate class of net assets in the statement of activities.

Conditional promises

B85. Paragraph 27 of this proposed Statement requires the acquirer to apply the guidance in Statement 116 to account for assets acquired and liabilities assumed as part of the merger or acquisition that are associated with conditional promises to give or to receive. The Board considered whether conditional promises to give or to receive should be recognized consistent with this proposed Statement's requirements for contingencies or the existing requirements in Statement 116. Consistent with its conclusion for certain collection items, the Board concluded that the requirements in Statement 116 should take precedence for purposes of this proposed Statement.

B86. When the Board issued Statement 116 in 1993, it concluded that "in certain circumstances, uncertainties may be so significant that recognition of an asset or liability must be delayed until there is adequate evidence that it exists, has value, and can be reliably measured" (paragraph 75). Paragraph 79 of that Statement states:

> The Board believes that until the condition is substantially met, there is insufficient basis to make a presumption about the expected outcome. Doubt remains about whether all or none of the promised assets will be realized. Presently, there are no cost-effective techniques to measure with sufficient reliability the value of a conditional right to receive a promised gift or a conditional obligation to deliver a promised gift. The Board concluded that substantially meeting the condition is the underlying event resulting in a contribution to the promisee from the promisor and until that event occurs a contribution should not be recognized, regardless of whether the promisor has already transferred the assets or has promised to transfer the assets in the future.

In that Statement, the Board concluded that conditional promises should not be recognized in the financial statements until the conditions on which they depend are substantially met. However, the Board did not reach a conclusion about whether a conditional right to receive a promised gift or a conditional obligation to deliver a promised gift **meets the definition of an asset or liability** as defined by Concepts Statement 6 prior to the conditions being substantially met.

B87. This proposed Statement's approach for assets and liabilities related to **contingencies** is different from the recognition approach in Statement 116. This proposed Statement's approach would require the acquirer to assess whether a contingent gain or loss gives rise to an asset or liability as defined by Concepts Statement 6. The approach represents a change from the accounting for gain or loss contingencies in FASB Statement No. 5, *Accounting for Contingencies,* which often results in delayed recognition when the uncertainty is resolved.

B88. The Board's project on the conceptual framework is currently under way. That project includes reconsiderations of the definitions of an asset and a liability as well as how accounting should address uncertainties surrounding assets and liabilities. Those reconsiderations may provide future insight and guidance to comprehensively address conditional promises and other arrangements. Until those reconsiderations are completed, the Board concluded that the recognition requirements in Statement 116 should take precedence for purposes of this proposed Statement.

Assembled workforce

B89. The Board also considered whether its decisions related to an assembled workforce in Statement 141, which were carried forward in proposed Statement 141(R), should apply to mergers and acquisitions by not-for-profit organizations. Paragraphs B168 and B169 of Statement 141 state:

> The Board recognizes that the intellectual capital of an assembled workforce is an important resource of many entities. The Board therefore decided that [Statement 141] should address whether an assembled workforce of at-will employees should be recognized as an intangible asset apart from goodwill.
>
> Some constituents believe there are circumstances under which an assembled workforce could be viewed as meeting either the contractual-legal criterion or the separability criterion for recognition as an asset apart from goodwill. However, the Board decided not to explicitly consider whether and in what circumstances an assembled workforce would meet those criteria. The Board observed that even if an assembled workforce met the criteria for recognition as an intangible asset apart from goodwill, the technique often used to measure the fair value of that asset is replacement cost—the cost to hire and train a comparable assembled workforce. The Board believes that replacement cost is not a representationally faithful measurement of the fair value of the intellectual capital acquired in a business combination. The Board concluded that techniques to measure the value of an assembled workforce and the related intellectual capital with sufficient reliability are not currently available. Consequently, it decided to make an exception to the recognition criteria

> and require that the fair value of an assembled workforce acquired be included in the amount initially recorded as goodwill, regardless of whether it meets the recognition criteria. . . .

The Board decided that the same conclusion should apply to assembled workforces that are acquired in a merger or acquisition by a not-for-profit organization.

Measurement principle

B90. The Board decided that, in principle, fair value is the relevant attribute for measuring the identifiable assets acquired and liabilities assumed in a merger or acquisition of a business or nonprofit activity. Thus, this proposed Statement would:

a. Eliminate the practice of recognizing the acquiree's assets at the acquiree's carrying value, which is the existing practice for those not-for-profit organizations that analogize to the pooling method described in Opinion 16.
b. Significantly reduce the use of inconsistent measures for specified assets and liabilities, which is the existing practice for those not-for-profit organizations that analogize to the purchase method described in Opinion 16.

B91. The pooling method in Opinion 16 requires that the combining entity's assets and liabilities be measured at their carrying value (that is, there is no remeasurement when those assets and liabilities are recognized in the financial statements of the combined entity). The purchase method in Opinion 16 requires that an acquirer allocate the cost (rather than the fair value) of an acquiree to the assets acquired and liabilities assumed. Paragraph 37 of that Opinion requires a variety of measures for that allocation, including fair values, current replacement costs, net realizable values, or in accordance with other GAAP. The Board acknowledges that the guidance for applying the pooling method and some of the guidance for applying the purchase price allocation process conflicts with measuring the fair values. In proposed Statement 141(R) and in this proposed Statement, the Board concluded that measuring assets acquired or liabilities assumed at amounts other than their fair values at the acquisition date does not faithfully represent their economic values or the acquirer's economic circumstances resulting from the merger or acquisition.

B92. The Board also observed that the use of the fair value measurement attribute is consistent with other standards that are currently applied by not-for-profit organizations, such as Statement 116 and Opinion 29. The Board comprehensively addressed and discussed fundamental issues surrounding fair value measurements that provide relevant guidance for measuring the fair values of assets and liabilities in FASB Statement No. 157, *Fair Value Measurements.* The Board concluded that this proposed Statement's measurement requirement will provide information that will better reflect the value of the assets received and the liabilities assumed.

Exceptions to the fair value measurement principle

B93. The Board decided to allow certain exceptions to the application of this proposed Statement's principle of measuring the identifiable acquired assets and assumed liabilities. Paragraphs 42–48 of proposed Statement 141(R) provide exceptions to the requirement that the acquirer measure the acquisition date fair values of the identifiable assets acquired and liabilities assumed separately from goodwill. Those exceptions are for assets held for sale, deferred taxes, operating leases, and certain employee benefit plans. For the reasons discussed in paragraphs B94–B102, the Board concluded that those exceptions also should apply to mergers and acquisitions by not-for-profit organizations.

Assets held for sale

B94. Paragraph 34 of this proposed Statement states:

> An acquirer shall measure an acquired long-lived asset (or disposal group) that is classified as held for sale as of the acquisition date at fair value less cost to sell. Further guidance in applying that requirement is included in paragraphs 30–32 and 34 and 35 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.*

B95. In this proposed Statement, the Board affirmed the conclusions reached in proposed Statement 141(R). Paragraph B144 of that proposed Statement explains that:

> The Board was concerned that if this Statement [141R] required those assets to be measured at fair value, a loss would be recognized immediately after the acquisition date, since Statement 144 would apply and require [remeasurement at fair value less] costs to sell in accordance with that Statement [rather than this Statement's measurement at fair value]. The Board concluded that assuming that there are no changes in events or other circumstances following the acquisition date, that reported loss [from remeasurement at fair value less costs to sell] would not fairly represent the activities of the acquirer during that period. Thus, the Board decided to require that long-lived assets (disposal group) that qualify as held for sale at the acquisition date be measured and recognized in accordance with the requirements of Statement 144.

Deferred taxes

B96. Not-for-profit organizations generally are exempt from income taxes under the Internal Revenue Code and most state laws. However, organizations may be subject to certain income taxes (for example, income taxes on unrelated business income). To the extent that an organization is subject to income tax, the Board considered whether that organization also should be subject to the same financial reporting requirements as business entities in accounting for income taxes as part of a merger or acquisition.

B97. The Board concluded that acquiring organizations that are subject to taxes on various portions of their income should account for deferred and current tax assets (including valuation allowances) and liabilities consistent with acquirers that are business entities. Therefore, deferred tax assets or liabilities would be measured and recognized in accordance with FASB Statement No. 109, *Accounting for Income Taxes*, as amended, rather than at their acquisition date fair values.

B98. The Board provided an exception to the fair value measurement principle in this proposed Statement and in proposed Statement 141(R) because of the complexities of the subsequent measurement. To overcome those difficulties, Statement 109 would need to be comprehensively reconsidered. The Board concluded that the benefits of applying the fair value measurement principle were not sufficient to warrant the costs or complexities that the application of that principle would cause at this time.

Operating leases

B99. The financial reporting requirements for operating leases are the same for not-for-profit organizations and business entities. FASB Statement No. 13, *Accounting for Leases*, does **not** require the separate recognition of assets and liabilities for rights and obligations of operating leases. In proposed Statement 141(R), the Board considered whether the principle of recognizing assets acquired and liabilities assumed should require separate recognition of those assets and liabilities. In that proposed Statement, the Board concluded that because it is not prepared at this time to address how the asset and the liability for an operating lease should be accounted for after the acquisition date, consistency in lease accounting should take precedence over consistency in the application of the fair value measurement requirement in that proposed Statement. Therefore, consistent with current practice in accordance with Statement 141:

a. An acquirer would recognize as a net amount the asset and the liability arising from an operating lease in which the acquiree is the lessee.
b. An acquirer would recognize as part of the merger or acquisition an intangible asset if the terms of the operating lease are favorable relative to market terms or recognize a liability if the terms of the operating lease are unfavorable relative to market terms.

B100. In this proposed Statement, the Board concluded that those requirements for operating leases for acquirers that are business entities also should apply to not-for-profit organizations.

Employee benefit plans

B101. Not-for-profit organizations are subject to FASB Statements No. 87, *Employers' Accounting for Pensions*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. Like business entities, those organizations provide a variety of different plans to their participants. While there are some differences in the disclosure requirements depending on whether an entity is public or nonpublic, the recognition and measurement requirements of those two Statements are the same. In proposed Statement 141(R), the Board provided an exception to the recognition and measurement principles for certain assets and liabilities related to certain employee benefit plans. Specifically, that exception is for assets and liabilities related to the acquiree's employee benefit plans that are within the scope of Statements 87 and 106, as amended by proposed Statement 141(R). Rather than being recognized and measured at their acquisition date fair values, any asset or liability related to the acquiree's employee benefit plans that is within the scope of Statements 87 and 106 would be recognized and measured in accordance with paragraph 74 of Statement 87 or paragraphs 86–88 of Statement 106.

B102. The Board provided that exception in proposed Statement 141(R) because of the complexities associated with subsequent measurement. To overcome those difficulties, Statements 87 and 106 would need to be comprehensively reconsidered or alternative subsequent measurement requirements would need to be considered. Therefore, in this proposed Statement, the Board decided to provide the same exception to not-for-profit acquirers for assets and liabilities related to the acquiree's employee benefit plans that are within the scopes of Statements 87 and 106.

Guidance for particular identifiable assets acquired and liabilities assumed

B103. In developing proposed Statement 141(R), the Board considered whether exceptions to the principle of recognizing and measuring assets acquired and liabilities assumed at their acquisition date fair values should be made for trade receivables and other short- or long-term receivables acquired, contingencies that meet the definitions of assets or liabilities, and research and development assets. The Board concluded that exceptions should not be provided for those items. Because those assets and liabilities may not be currently recognized or measured at fair value in a business combination (or, in the case of research and development assets, immediately expensed following the acquisition), the Board provided additional application guidance in that proposed Statement. Paragraphs B119–B141 of proposed Statement 141(R) discuss the Board's considerations and conclusions about applying this proposed Statement's principle for recognizing and measuring particular assets acquired and liabilities assumed.

B104. While the acquisition of some of those assets and incurrence of those liabilities may be less frequent in a merger or acquisition by a not-for-profit organization, they may still be present. Therefore, the Board included the same application guidance in this proposed Statement. Paragraphs B105–B108 discuss the Board's considerations about donor-related intangible assets other than goodwill. Paragraphs B109–B118 discuss the Board's considerations about contingencies that meet the definition of an asset or liability.

Recognition of donor-related intangible assets

B105. A resource group member suggested that the Board provide guidance in this proposed Statement for recognizing donor-related intangible assets, such as donor lists and donor relationships, apart from goodwill. The Board agreed. The Board also observed that donor-related intangible assets are similar to customer-related intangible assets and decided its approach for developing the guidance for donor lists and donor relationships should be consistent with proposed Statement 141(R).

B106. The Board supported that approach because previous input from constituents indicated that donor relationships are often among the main reasons for a combination, just as customer relationships are often one of the main reasons for a business combination. Additionally, the methods used to value a donor relationship are similar to those that could be used to value customer relationships.

B107. Some Board members disagree that donor relationships are similar to customer relationships. Those members also have concerns about whether donor-related intangible assets can be measured with sufficient reliability and can be separated from the value of the acquiree. They note that donor relationships, unlike customer relationships, arise from contributions that have distinct characteristics that separate them from the transactions considered in developing the guidance for customer relationships. First, unlike customers, donors do not expect to receive goods and services in return for the payments they make. Second, donors often have personal affinities and attachments to organizations rather than commercial attachments.

B108. The Board concluded that the guidance for donor lists and donor relationships should be consistent with proposed Statement 141(R). The Board also concluded that further input from constituents should be sought through the comment letter process about the measurability and separability of those identifiable donor relationships.

Initial recognition and measurement of contingencies that meet the definition of assets or liabilities

B109. Paragraph 18 of this proposed Statement requires that an acquirer "recognize an asset or liability arising from contingencies acquired or assumed in a merger or acquisition if that asset or liability meets the definition of an asset or a liability in Concepts Statement 6. That asset or liability may not have been recognized in the preacquisition financial statements of the acquiree because the recognition criteria in Statement 5 were not met." That proposed requirement is consistent with proposed Statement 141(R).

B110. The Board supported that requirement in this proposed Statement for the same reasons noted in proposed Statement 141(R). Those reasons are:

a. In principle, all assets acquired and liabilities assumed should be measured and recognized at their acquisition date fair values.
b. In principle, measuring contingencies at their fair value is consistent with using a fair value measure for the initial recognition of many other assets and liabilities that have inherent risks and uncertainties.
c. Substantially all assets (perhaps other than cash) involve some uncertainty about the timing and amount of future benefits. Fair value incorporates that uncertainty in the measurement of the asset or liability rather than its recognition.

However, for the reasons noted in paragraphs B85–B88, the Board did not extend those requirements to conditional promises.

B111. Significant practice concerns were raised during the development of proposed Statement 141(R), including that when requiring a measurement of the fair values of contingencies at the acquisition date:

a. The information needed to measure the acquisition date fair value of an asset or liability may not be available or of sufficient quality at that date.
b. Measuring assets and liabilities that are significantly more difficult to measure is likely to require measurement guidance.

B112. The Board responded to those concerns in two ways. First, it provided a period of time (up to one year following a merger or acquisition) for the acquirer to obtain necessary information and during which it may adjust the estimates of the acquisition date fair values of assets and liabilities. Second, it issued Statement 157, which provides relevant guidance for measuring the fair values of assets and liabilities.

B113. In proposed Statement 141(R), the Board also noted that there is a difference between the measurement of the fair value of an asset or liability and its ultimate outcome. Paragraphs B127 and B128 of that proposed Statement state:

> . . . a reliable measurement of the fair value of a contingency does not mean that the acquirer must be able to determine, predict, or otherwise know the ultimate settlement amount of that contingency at the acquisition date or within the measurement period.
>
> Assumptions used in a fair value measurement are based on expectations at the time the measurement is made, and those expectations reflect the information that is available at the time of measurement. The fair value of the items measured will change over time as factors used to estimate their fair value change. Changes in the fair value of those items are a normal economic process to which any valuable resource is subject. Such changes do not indicate that the expectations on which previous fair value measurements were based were unreliable or incorrect. The fair value of those items at a single point in time is not a forecast of what the estimated fair value of those items may be in the future.

B114. Paragraphs 55–61 of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, discuss how fair value measures differ from the recognition of a loss contingency under Statement 5. In summary, that guidance observes that both Statement 5 and a fair value measurement consider uncertainty inherent in future cash flows (amount and timing). Statement 5 considers uncertainty in the context of recognition, establishing a probability threshold for when to recognize a loss contingency. In contrast, a fair value measurement considers uncertainty in the context of measurement, incorporating uncertainty directly in the measurement.

B115. The Board concluded that this proposed Statement's measurement period and the guidance in Statement 157 are a reasonable way to accommodate concerns about the quality and unavailability of information and concerns about the need for additional guidance to measure fair value.

Subsequent measurement of contingencies

B116. In proposed Statement 141(R), the Board also addressed how assets acquired and liabilities assumed for contingencies should be measured after a business combination. Although that proposed Statement is directed at accounting for a business combination—not transactions and events that occur **after** a business combination—the Board observed that application of Statement 5 in the postcombination period could be problematic. Paragraph B136 of proposed Statement 141(R) states:

> The Board noted that if Statement 5 was applied in the postcombination period to a recognized liability (asset) for a contingency of an acquiree that did not meet the Statement 5 probability threshold at the acquisition date, in the absence of a change in circumstances, that liability (asset) would be derecognized and a gain (loss) would be reported in income of the postcombination period. The Board concluded that that would lead to financial reporting that does not faithfully represent the economic circumstances for that period.

B117. In this proposed Statement, like proposed Statement 141(R), the Board concluded that:

a. For the subsequent measurement of changes in the fair value of assets and liabilities that are financial instruments, current GAAP provides appropriate guidance. Therefore, those assets and liabilities should continue to be measured at fair value in accordance with applicable GAAP.
b. For the subsequent measurement of assets and liabilities that are nonfinancial instruments, the Statement 5 approach often fails to measure and recognize an existing asset or liability. Fair value is the most relevant measurement attribute for those assets and liabilities related to contingencies.

B118. The Board also concluded that assets acquired and liabilities assumed related to contingencies are generally the same for a business entity or for a not-for-profit organization and have the same underlying economics. For example, an acquirer may assume a liability associated with a lawsuit regardless of whether the acquirer or the acquiree is a business entity or a not-for-profit organization. Therefore, the Board concluded that generally the same requirements for accounting for contingencies that apply to an acquirer that is a business entity also should apply to an acquirer that is a not-for-profit organization.

Recognizing and Measuring Goodwill and Contributions Received

B119. One of the principles of this proposed Statement and proposed Statement 141(R) is that the fair value of an acquiree should be measured in a merger or acquisition. In applying the acquisition method, the acquirer would use the fair value of the acquiree to calculate the goodwill and any contribution (or bargain) received. However, the Board concluded that this proposed Statement should provide an exception for mergers and acquisitions by not-for-profit organizations to the principle of measuring the acquisition date fair value of the acquiree as a whole. That exception also is an exception to the requirement in Statement 116 to measure the fair value of a contribution received. The Board concluded that in a merger or acquisition of a business or nonprofit activity by a not-for-profit organization, the acquirer should recognize goodwill or a contribution received based on the acquisition date fair values of the identifiable assets acquired, liabilities assumed, and consideration transferred (the "net asset approach"). Paragraphs B121–B140 provide the Board's rationale that led to that exception.

B120. Additionally, consistent with its conclusion in Statement 141, the Board affirmed its conclusion that goodwill meets the definition of an asset. In this proposed Statement, the Board also explicitly considered the recognition of goodwill in mergers and acquisitions of net deficits. Paragraphs B145–B148 provide the Board's considerations on those recognition issues.

The net asset approach

B121. In developing this proposed Statement, the Board observed two distinct types of mergers and acquisitions by not-for-profit organizations: those that involve a bargained exchange (reciprocal transactions) and those in which the net assets of the acquiree are contributed to the acquirer for no consideration or for consideration that is substantially less than the value of the net assets (nonreciprocal or partially nonreciprocal events or transactions). While the distinction between those transaction types, commonly called purchases and contributions (gifts), is clear in concept, the line between the two is sometimes blurred in practice.

B122. This proposed Statement would provide the accounting for all mergers and acquisitions of a business or a nonprofit activity by a not-for-profit organization, including those that involve a gift to the acquirer. The Board decided that rather than requiring one approach for mergers and acquisitions of a nonprofit activity by gift and another for those by purchase, applying a single approach would be preferable. That is, a single approach could reduce complexity and increase understandability of the resulting information. Thus, the Board decided to require a **net asset approach** to account for any goodwill and inherent contributions for all mergers and acquisitions of businesses and nonprofit activities by not-for-profit organizations. Under that approach, an acquirer would recognize either goodwill acquired, to the extent that consideration transferred is **more than** the identifiable net assets acquired, or a contribution received, to the extent that the consideration transferred, if any, is **less than** the identifiable net assets acquired. The Board decided to require that alternative and less costly approach for measuring goodwill or a contribution received because of the difficulties and cost of obtaining information for making the measure, because of concerns about the reliability of the measure, and because of questions about the benefits of information about goodwill to users of the financial statements.

Difficulty and cost of obtaining information

B123. The Board believes that the application of other valuation approaches could be significantly more problematic because of the absence of available and comprehensive comparable market transactions for similar nonprofit activities and an absence of a profit-driven "business" motive. Those absences make both the market approach and the income approach to valuation more difficult, raise questions about the quality of the resulting estimates, and raise concerns about the costs to obtain those estimates in certain mergers and acquisitions.

B124. Opinion 16, Statement 141, and proposed Statement 141(R) all require that goodwill be measured as a residual rather than at its acquisition date fair value. In developing this proposed Statement, the Board concluded that direct measurement of the fair value of goodwill is impracticable. In proposed Statement 141(R), the Board decided that the calculation of goodwill by business entities should be based on the fair value of the acquiree as a whole. That value is presumptively equal to the consideration exchanged for the acquiree in a business combination. Under that approach, goodwill would be calculated as the difference between the fair value of the acquiree and the net amount of the values of the acquired assets and assumed liabilities. In a bargained exchange in which a not-for-profit organization purchases the net assets of a business or nonprofit activity, the Board concluded that the measurement approach and presumption in proposed Statement 141(R) could apply equally as well.

B125. Other mergers and acquisitions by not-for-profit organizations occur through or involve a gift to the acquirer. The Board considered whether those contributions received in a merger or acquisition should be accounted for consistent with Statement 116. Paragraph 5 of Statement 116 defines a contribution as "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." The Board reached the following basic conclusions in Statement 116:

a. A contribution made and a corresponding contribution received should be recognized by both the donor and the donee at the same time, that is, upon occurrence of the underlying event, which is the nonreciprocal transfer of an economic benefit.
b. Fair value is the relevant measurement attribute and measurement objective for a contribution made and a contribution received.
c. Contributions are generally measurable with sufficient reliability by both donors and donees.
d. Certain forms of contributed resources may be more difficult to measure reliably than others, but the form of the contributed resources alone should not change conclusions about whether to recognize the underlying event.
e. A major uncertainty about the existence of value may indicate that a specific item received or given should not be recognized. If an item is accepted solely for a potential educational value or historical significance and has no alternative use, it may have uncertain value, or no value, and should not be

recognized. For example, contributions of flora, fauna, photographs, and objects that are identified with historic persons, places, or events often have no value or have highly restricted alternative uses.

B126. In theory, if the Board applied the basic conclusions in Statement 116 to mergers and acquisitions involving a gift, a contribution received should be recognized. That contribution would be equal to the fair value of the acquiree as a whole in circumstances in which no consideration is exchanged. However, in mergers and acquisitions between not-for-profit organizations involving a gift, the Board concluded that an exception should be provided to the requirement to measure the fair value of the acquiree.

B127. First, if there is no consideration of commensurate value exchanged, measuring the acquiree based on the fair value of the consideration transferred is not possible. The Board acknowledges, however, that other valuation approaches could be used, such as the market and income approaches described in paragraphs A18–A23 of proposed Statement 141(R), to determine the fair value of the acquiree. The use of other valuation approaches would be required for acquirers that are business entities, including mutual entities. Paragraph 20 of proposed Statement 141(R) states:

> In some business combinations, either no consideration is transferred on the acquisition date or the evidence indicates that the consideration transferred is not the best basis for measuring the acquisition-date fair value of the acquirer's interest in the acquiree. In those business combinations, the acquirer should measure the acquisition-date fair value of its interest in the acquiree using other valuation techniques.

B128. The Board rejected the application of those other valuation approaches for acquisitions of **nonprofit activities** by not-for-profit organizations. The Board concluded that those approaches could be significantly more problematic for acquisitions of a nonprofit activity. Additionally, the Board observed that not-for-profit organizations and mutual entities are fundamentally different. While mergers and acquisitions by both not-for-profit organizations and mutual entities often occur without an explicit exchange of consideration, the Board observed that there are some fundamental differences between those entities. Those differences are:

a. **Contributions.** Not-for-profit organizations generally receive charitable contributions (donations). Mutual entities are not charities and are operated like a business to provide a benefit or return to their members.
b. **Who receives the benefit.** In a merger or acquisition by a not-for-profit organization, there is no business or member equity. In a merger or acquisition by a mutual entity, the consideration exchanged is often a membership share of the acquiree for a membership share of the combined entity.
c. **Measurability.** In a merger or acquisition by a not-for-profit organization, measuring the fair value of some acquirees would pose significant measurement difficulties because there often is no consideration transferred or market price for comparable transactions, and there are difficulties applying the income approach because the entity does not operate on a for-profit basis.

> However, an acquiree that is a mutual entity or a private business can be measured by using available market information for comparable transactions, an income approach, or both.

Reliability of the measure

B129. The Board considered the extent to which the reliability of the measure affects the resulting financial information. Paragraph 75 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, states:

> To be reliable, information about an item must be representationally faithful, verifiable, and neutral. To be reliable, information must be sufficiently faithful in its representation of the underlying resource, obligation, or effect of events and sufficiently free of error or bias to be useful to investors, creditors, and others in making decisions. To be recognized, information about the existence and amount of an asset, liability, or change therein must be reliable. [Footnote reference omitted.]

B130. The Board acknowledged in Statement 141 that there are some difficulties of faithful representation in recognizing goodwill. Paragraphs B131–B135 of Statement 141 mention the following problems with faithful representation of a goodwill amount. Goodwill is not representationally faithful to the extent that it includes:

a. An excess of fair value over book values of the identifiable acquired assets or assumed liabilities of the acquiree (that is, exceptions to the fair value measurement requirement)
b. The fair value of unrecorded intangible assets
c. An overvaluation of the consideration transferred by the acquirer
d. An overpayment by the acquirer.

B131. The Board acknowledges that the benefits to users of information about goodwill are reduced because of those problems. Therefore, so that the costs to apply this proposed Statement do not exceed the benefits to users of the financial statements, the Board decided to reduce the cost of implementing and maintaining the goodwill recognition model in this proposed Statement by requiring the application of the net asset approach.

Decision usefulness of goodwill acquired by a not-for-profit organization

B132. The Board considered whether the recognition of goodwill enhances the decision usefulness of the not-for-profit organization's financial statements for the various users of those statements, including creditors and others seeking or requiring a return on their investments, donors, grantors, and potential donors. The Board concluded that information about goodwill may be of limited use to donors in their assessments of whether to provide resources to a not-for-profit organization. Information about goodwill could be useful to creditors who, unlike donors, are interested in return on and return of their investment. However, because goodwill is not separately exchangeable, creditors first look to information about assets that can be directly used to settle obligations.

B133. The Board's considerations leading to the issuance of Statement 142 provide a foundation for understanding the information needs of creditors of a not-for-profit organization. The information needs of creditors of not-for-profit organizations and others who require a return of and return on their investments are similar to the needs of a business entity's investors and creditors. In the project that led to Statement 142, the Board learned during its field visits that many analysts disregard goodwill amortization expense in assessing a business entity's performance. The Board also learned that a business entity's management also often ignores goodwill amortization in measuring operating performance internally. However, both analysts and management of business entities often include goodwill in total assets when computing performance ratios such as return on assets or return on equity.

B134. Performance measures for not-for-profit organizations differ from those used to evaluate business entities. Because a not-for-profit organization is not operated with the goal of maximizing return in the typical sense, many of their performance measures do not focus on return on assets, return on net assets, or on a single performance measure similar to net income. Paragraph 9 of Concepts Statement 4 establishes two performance indicators for not-for-profit organizations: information about the nature of and relationship between inflows and outflows of resources and information about service efforts and accomplishments. Paragraph 49 of Concepts Statement 4 further elaborates on the first of those indicators:

> . . . financial reporting must distinguish between resource flows that are related to operations and those that are not. In this way, financial reporting may provide information that is useful in assessing whether the activities of a nonbusiness organization during a particular period have drawn upon, or have contributed to, past or future periods. Thus, it should show the relation of resources used in operations of a period to resource inflows available to finance those operations. Similarly, it should provide information about changes in resources that are not related to operations. [Footnote reference omitted.]

B135. The Board is not convinced that reporting goodwill on the statement of financial position or the impairment of goodwill in the statement of activities meets that objective in Concepts Statement 4 any better than alternative methods. For example, if upon acquisition goodwill was immediately written off, users of financial statements could distinguish that event as one that was not related to operations if the Board was to require display of the write-off separately from revenues, expenses, gains, and losses.

B136. The Board also observed that some performance measures used for not-for-profit organizations are nonfinancial in nature. In part, that is because many of the individuals or entities that provide resources to a not-for-profit organization do so for reasons other than return of and return on their investments. For example, donors, grantors, and potential donors have motives other than a return on investment when making decisions about whether to provide resources to a not-for-profit organization. Paragraph 19 of Concepts Statement 4 explains that:

> . . . noneconomic reasons are commonly factors in decisions to provide resources to particular nonbusiness organizations. For example, contributors to philanthropic organizations, such as charities, and to some membership organizations, such as churches, generally seek no direct economic benefits. Rather, their reasons for voluntarily providing resources relate to their interests in furthering the purpose and goals of the organization. [Footnote reference omitted.]

B137. In paragraphs 51–53 of Concepts Statement 4, the Board concluded that the accomplishments of nonbusiness organizations generally cannot be measured in terms of sales, profit, or return on investment. Rather, information about service accomplishments of an organization is better furnished by manager's explanations and sources other than financial reporting. Information about service efforts should focus on how the organization's resources (inputs such as money, personnel, and materials) are used in providing different programs or services.

B138. The Board considered whether information about goodwill helps users of financial statements understand an organization's service efforts and accomplishments. The Board concluded that other information better serves that purpose. For example, rather than information about the amount of goodwill recognized in that acquisition, the Board believes that a combination of nonfinancial information and financial information would be more useful in evaluating the combined organization's ability to render future services.

Applying a single measurement approach

B139. The Board decided to extend to all mergers and acquisitions by not-for-profit organizations the exception to the principle of recognizing and measuring the fair value of the acquiree. The primary reason for that decision is that extending the exception to all mergers and acquisitions by a not-for-profit organization would reduce the complexity of the requirements. The Board observed that consistent application of this single approach would have several important benefits for all acquisitions of nonprofit activities and businesses by a not-for-profit organization. It would:

a. Increase understandability and comparability of the information provided.
b. Reduce the complexity of the guidance for not-for-profit organizations because the approach to recording goodwill and contributions would be the same for all acquisitions by not-for-profit organizations.
c. Result in accounting that would be consistent with the guidance in proposed Statement 141(R) for "bargain purchases." In a bargain purchase, goodwill is reduced first and a gain (for example, contribution equivalent) is recognized to the extent that the fair value the identifiable net assets acquired exceeds the consideration transferred. In theory, a bargain purchase is an acquisition in which the acquirer transfers consideration that is less than the fair value of the acquiree. Proposed Statement 141(R) would require the measurement of the acquiree as a whole for purposes of identifying the occurrence of a bargain purchase, but that amount would not be recognized as a gain. Instead, in a

bargain purchase the total amount of the net assets recognized would be based on the consideration transferred (the bargain price). The amount of the gain that otherwise would have been recognized through the application of the principles (that is, the fair value of the acquiree as a whole less the consideration paid) would be reduced by first decreasing goodwill to zero. The Board supported that exception because although the principle of measuring the fair value of the acquiree would be relevant for bargain purchases, the Board had concerns about the potential for inappropriate gain recognition resulting from measurement bias or undetected measurement errors.

d. Result in an acquirer recognizing the same amount of goodwill as would be recognized if applying proposed Statement 141(R) when an acquisition is an arm's-length exchange transaction in which 100 percent of the acquiree is acquired and no contribution is involved. In mergers and acquisitions by not-for-profit organizations in which there is an arm's-length exchange between knowledgeable, unrelated, willing parties, the consideration transferred would likely be equal to the acquisition date fair value of the acquiree.
e. Reflect the possibility that an organization could acquire a business in a transaction that was in part an exchange and in part a contribution.
f. Require the acquiring organization to recognize the contribution inherent in an acquisition as a contribution received to the extent that the fair value of the identifiable net assets acquired exceeds the consideration transferred. That voluntary nonreciprocal nature of an acquirer receiving a contribution is idiosyncratic to and is common in mergers and acquisitions by those organizations.
g. Reduce the costs of application without substantially reducing the benefits. The information necessary to measure the fair value of discrete items of consideration transferred by the acquirer, such as cash and promissory notes, generally is readily available to the acquirer or obtainable at a lower cost than measuring the fair value of the acquiree.

B140. The Board acknowledges the potential loss of information from applying this exception is that a not-for-profit acquirer may:

a. Understate the measurement of the assets acquired (that is, goodwill and other intangible assets that are not identifiable) and the contribution received by the acquirer. For example, the acquirer may be the recipient of a contribution of an acquiree that has significant goodwill or significant value in its workforce.
b. Omit from recognition the assets acquired and contributions received by the acquirer. For example, the acquirer may transfer consideration that is less than the fair value of the identifiable net assets of the acquiree (that is, the acquirer would receive a partial gift or would pay less than the fair value of the acquiree). In those circumstances, if the acquiree has significant goodwill or significant value in its workforce, none of the contribution received for those assets would be recognized by the acquirer.

However, the Board believes that potential loss is outweighed by the reduction in costs. A not-for-profit acquirer would not be required to measure the fair value of the acquiree as a whole, which significantly reduces the costs of applying this proposed Statement.

Recognition of goodwill

B141. This proposed Statement would require the recognition of goodwill as an asset in a merger or acquisition by a not-for-profit organization. That recognition requirement is consistent with the overarching principle in this proposed Statement to recognize the assets acquired and liabilities assumed in a merger or acquisition. In the past, some constituents expressed their views that goodwill is not an asset. However, consistent with its conclusion in Statement 141, the Board concluded that goodwill acquired by a not-for-profit organization meets the definition of an asset. Paragraph B107 of Statement 141 states:

> Opinion 16 defined goodwill as the "excess of the cost of the acquired company over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed" (paragraph 87). That definition describes how the cost of goodwill should be calculated rather than explaining what goodwill is or what it represents. As such, it confuses the substance of goodwill with how goodwill is to be measured.

B142. In considering whether goodwill meets the definition of an asset, the Board considered the three essential characteristics of an asset described in Concepts Statement 6:

> . . . (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. [paragraph 26]

Paragraphs B111–B116 of Statement 141 provide analysis of how goodwill meets each of those three essential characteristics.

B143. Paragraph B102 of Statement 141 describes the six components that are included in the amount that is recognized as goodwill in a business combination in practice. In that Statement, the Board concluded that two of those components are conceptually part of goodwill:

> Component 3—The fair value of the "going-concern" element of the acquired entity's existing business. The going-concern element represents the ability of the established business to earn a higher rate of return on an assembled collection of net assets than would be expected if those net assets had to be acquired separately. That value stems from the synergies of the net assets of the business, as well as from other benefits (such as

factors related to market imperfections, including the ability to earn monopoly profits and barriers to market entry—either legal or because of transaction costs—by potential competitors).

Component 4—The fair value of the expected synergies and other benefits from combining the acquiring entity's and acquired entity's net assets and businesses. Those synergies and other benefits are unique to each combination, and different combinations would produce different synergies and, hence, different values.

B144. In this proposed Statement, the Board concluded that both of those components can be present in mergers and acquisitions by not-for-profit organizations. Consistent with Statement 141, the third component relates to the acquiree and reflects the excess assembled value of the acquiree's net assets. It represents the preexisting goodwill that was either internally generated by the acquiree or acquired by it in prior mergers and acquisitions. The fourth component reflects the excess assembled value that is created by the merger or acquisition and relates to the synergies that are expected from joining those businesses or nonprofit activities.

Recognition of goodwill in mergers and acquisitions of net deficits

B145. During the Board's deliberations, several constituents expressed concerns about the nature of the excess in a merger or acquisition in which the liabilities assumed exceed the identifiable assets acquired (a net-deficit merger or acquisition). Some suggested that the nature of the excess is a contribution made by the acquirer. Others view the nature of the excess as an acquired unidentifiable intangible asset, that is, goodwill. The Board's discussions with constituents led to the following observations about the possible reasons an acquirer would assume the net deficit of the acquiree:

a. The acquirer believes the merger or acquisition would result in operating synergies.
b. The acquirer acquires identifiable or unidentifiable assets that did not meet the recognition criteria (such as a collection or an assembled workforce).
c. The acquirer erroneously understates the acquisition date fair values of the identifiable acquired assets.
d. The acquirer erroneously overstates the acquisition date fair values of the liabilities assumed.
e. The acquirer contributes to the acquiree or to the community (for example, the acquirer decides to assume the liabilities of the acquiree to preserve the acquiree's standing in the community or mission).
f. The acquirer "overpays" for the acquiree.

B146. The Board concluded that many of the reasons cited support the existence of goodwill. However, some of the reasons support the recognition of an expense. This proposed Statement does not require the identification or separation of the net deficit into the items in paragraph B145. In determining whether goodwill should be recognized in a merger or acquisition in which there is a net deficit, the Board considered the characteristics and conceptual recognition requirements for each of the items. Items (a) and (b) in the list are valid sources of recognized goodwill (see paragraph B143). Items (c) and (d) conceptually are not part of goodwill, but the Board acknowledges that they might be subsumed in goodwill. Item (e) should be recognized as an expense, consistent with Statement 116. Item (f) conceptually should be an expense but it is typically subsumed in goodwill because the "overpayment" is not known at the date of acquisition. Therefore, of the above list of six items, four are typically included in goodwill. Two items (Items (e) and (f)—a contribution made to the acquiree or the community and an "overpayment") conceptually should be expensed.

B147. Because the fair value of an acquiree is not measured, the acquirer cannot objectively determine whether the excess is goodwill, an overpayment, or a gift to the acquiree in net deficit situations. The Board concluded that the excess should be recognized as goodwill rather than as contribution expense. The primary reason for its conclusion is that the fiduciary responsibilities of an acquiring organization and its directors would preclude them from assuming the liabilities of a financially weaker organization unless they believed there was some unidentifiable intangible asset, such as goodwill. Additionally, if an acquirer assumed an acquiree's liabilities that exceeded both its identifiable and unidentifiable assets, the acquirer essentially would be making a charitable contribution to another organization's creditors, which would be highly unlikely.

B148. The Board also considered whether this proposed Statement should include provisions to account for a business combination in which a buyer pays an amount that is more than the fair value of its interest in the acquiree. The Board acknowledged that that circumstance is possible and, in concept, an overpayment should lead to recognition of an expense by the acquirer. However, the Board believes that in practice that circumstance, if it occurs, would not be detectable or known at the acquisition date. That is, the Board is aware of no instances in which a buyer knowingly should overpay a seller to acquire a business or would be otherwise compelled to make such an overpayment. Rather, the Board believes that an acquirer's overpayment, although rare, occurs unknowingly and generally is a result of misinformation at the acquisition date. Thus, consistent with its conclusion in B183 of proposed Statement 141(R), the Board concluded that in practice it is not possible to identify and reliably measure an overpayment at the acquisition date. The Board concluded that the accounting for overpayments is best addressed through subsequent impairment testing when evidence of a potential overpayment first arises.

Measuring the fair value of the consideration transferred

B149. Paragraph 38 of this proposed Statement requires that an acquirer "measure the fair value of the consideration transferred in exchange for an acquiree, if any, as of the acquisition date." An acquirer would be required to use the fair value of the consideration transferred in exchange to measure the amount of goodwill or contribution received in a merger or acquisition.

Contingent consideration

B150. Opinion 16 defines contingent consideration as "consideration which is issued or issuable at the expiration of the contingency period or which is held in escrow pending the outcome of the contingency . . .” (paragraph 78). The Board concluded in proposed Statement 141(R) that “. . . consistent with the general principle for recording a business combination, obligations for contingent consideration would be measured . . . at fair value on the acquisition date” (paragraph B75). To the extent that those arrangements exist, the Board concluded that not-for-profit organizations should apply the same accounting requirements for contingent consideration as the requirements in proposed Statement 141(R) for business entities. That is, contingent consideration, like other consideration transferred, should be measured at its acquisition date fair value.

B151. Current guidance in Opinion 16 and Statement 141 may result in nonrecognition of obligations for contingent consideration at the acquisition date. Paragraphs B74 and B75 of proposed Statement 141(R) state:

> In accordance with the guidance in Statement 141, which was carried forward from Opinion 16 without reconsideration, obligations for the acquirer’s agreement to make contingent payments usually were not recorded at the acquisition date. Rather, they usually were recorded when the contingency was resolved and consideration was issued or became issuable. In general, the issuance of additional securities or distribution of additional cash or other assets upon resolution of contingencies based on reaching particular earnings levels resulted in delayed recognition of an additional element of cost of an acquired entity. In contrast, the issuance of additional securities or distribution of additional assets at the resolution of contingencies based on security prices did not change the recorded cost of an acquiree.
>
> The Board concluded that the cost accumulation and delayed recognition approach to accounting for contingent consideration in Statement 141 and Opinion 16 is unacceptable because it ignored the fact that the acquirer’s agreement to make contingent payments is the obligating event in a business combination transaction. That approach failed to recognize that upon promising to make contingent payments of cash or other assets, an acquirer incurred an obligation that meets the four fundamental recognition criteria identified in paragraph 63 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises.* That is:
>
> a. The obligation meets the definition of a liability (unless it can be settled in the entity’s own equity shares).
> b. The obligation has a relevant attribute (fair value) that is measurable with sufficient reliability.
> c. Information about the obligation is capable of making a difference in user decisions.
> d. The information is representationally faithful, verifiable, and neutral.
>
> The Board concluded that not recognizing the obligation of the acquirer at the acquisition date for such future contingent payments would not fairly

> represent the economic consideration exchanged at that date. The Board concluded that, consistent with the general principle for recording a business combination, obligations for contingent consideration should be measured and recognized at fair value on the acquisition date.

B152. Paragraphs B76–B79 of proposed Statement 141(R) further discuss the Board's considerations for the recognition and measurement of contingent consideration, including difficulties in and the reliability of the acquisition date measurement, potential for increased subjectivity, differences in the views of the buyer and seller about uncertainties of future outcomes, evidence surrounding the negotiations between a buyer and a seller, effect of delaying recognition of assets or liabilities, and classification of contingent consideration arrangements.

Costs incurred in connection with a merger or acquisition

B153. The Board observed that transaction-related costs incurred by business entities are similar to those incurred by not-for-profit acquirers. Paragraph 27 of proposed Statement 141(R) would require that those costs be accounted for separately from the business combination. The Board concluded in this Statement that that same requirement should apply to transaction-related costs incurred in connection with a merger or acquisition by a not-for-profit organization.

B154. The primary reason for the requirement in proposed Statement 141(R) is that transaction-related costs are not part of the fair value exchange between a buyer and a seller for the business because they are separate payments in exchange for services and generally do not represent assets of the acquirer at the acquisition date since they are consumed as the services are rendered. The Board affirmed that conclusion in this proposed Statement.

Determining whether specific items are part of the consideration transferred for the acquiree

B155. As in proposed Statement 141(R), the Board decided to include guidance that would require an assessment to determine whether any portion of the payment amounts are not part of the exchange or gift. Paragraph B99 of proposed Statement 141(R) states:

> The Board also considered concerns about the potential for abuse. Some constituents noted that if acquirers can no longer capitalize acquisition-related costs as part of the cost of the business acquired, they may use abusive practices to avoid recognizing those costs as expenses. . . . To mitigate such concerns, the Board decided to clarify in this Statement that the portion of any payments to an acquiree (or its former owners) in connection with a business combination that are payments for goods or services that are not part of the acquired business should be assigned to those goods or services and accounted for as if separately acquired. . . . The Board also decided that this Statement should specifically require an assessment to determine whether any portion of the payment amounts transferred by the acquirer are not part of the consideration transferred in

> exchange for the acquiree and the related assets acquired and liabilities assumed or incurred.

The Board concluded that those same concerns also would arise in mergers and acquisitions by not-for-profit organizations. Therefore, the Board confirmed that this proposed Statement should also specifically require an assessment to determine whether specific items are part of the consideration transferred for the acquiree.

Acquisitions of Less Than 100 Percent of an Acquiree

B156. This proposed Statement would require a not-for-profit organization that acquires less than 100 percent of an acquiree to recognize all identifiable assets and liabilities and to measure those assets and liabilities at their full fair values (or in limited cases their full amounts determined in accordance with other GAAP), including those of an acquiree (subsidiary) that is not wholly owned. Additionally, in an acquisition of less than 100 percent of a business, an acquirer would recognize the amount of goodwill purchased (that is, the goodwill that is related to the controlling interest), rather than recognize the full amount of goodwill as would be required by proposed Statement 141(R). The Board observed that while it may be unusual or infrequent in occurrence, some not-for-profit organizations may acquire an acquiree in stages or acquire less than 100 percent of the equity of an acquiree. For example, a not-for-profit organization may receive a contribution of or purchase a majority ownership in the equity of a business. The Board believes that any transaction or event that results in an organization obtaining control of the net assets of an acquiree should be accounted for consistently.

Acquisitions in Stages

B157. Some not-for-profit organizations may also acquire an acquiree in stages. For example, an organization may own 20 percent of a for-profit entity and may purchase another 60 percent of that entity and obtain control of the acquiree. In acquisitions that are achieved in stages, consistent with proposed Statement 141(R), the acquirer would be required to remeasure its noncontrolling ownership investment at its acquisition date fair value and recognize any gains or losses in income. Paragraph B156 of proposed Statement 141(R) includes the following reasons for that decision:

> Consistent with its conclusion . . . that losing control of a business is a remeasurement event, the Board concluded that gaining control of a business also is a remeasurement event. Specifically, a change from holding a noncontrolling investment in an entity to obtaining control of that entity is a significant change in the nature of and economic circumstances surrounding that investment. That change warrants a change in the classification and measurement of that investment. Board members observed that the acquirer no longer is the owner of a noncontrolling investment asset in that entity when control of the underlying entity is obtained. As in present practice, the acquirer ceases its investment accounting as an owner of an investment asset and begins reporting the underlying assets, liabilities, and results of operations of the entity as part

> of its consolidated results. In effect, the acquirer exchanges its status as an owner of an investment asset in an entity for a controlling financial interest in all of the underlying assets and liabilities of that entity (acquiree) and the right to direct how the acquiree and its management use those assets in conducting its operations.

The Board concluded that those same reasons apply to a not-for-profit organization that gains control of an acquiree in stages. Paragraphs B157–B160 of proposed Statement 141(R) further discuss that requirement.

Measurement Period

B158. In response to concerns about the quality and availability of information necessary to measure and recognize the acquisition date fair values at the acquisition date, this proposed Statement would permit acquirers to record provisional fair value estimates at the acquisition date followed by a measurement period during which the acquirer may adjust the provisional amounts recognized at the acquisition date (paragraphs 52–57). The objective, intention, and requirements of the measurement period are consistent with proposed Statement 141(R).

B159. The Board concluded that in applying the requirements for the measurement period, an acquirer should:

a. Only consider information that pertains to the values as of the acquisition date in recording assets acquired and liabilities assumed in a merger or acquisition. Information discovered about an event that occurred after the acquisition date should be recognized as part of the postacquisition accounting, not as part of the merger or acquisition.
b. Provide users of its financial statements with relevant information about the status of items that have been measured only provisionally. Therefore, paragraph 70(a) of this proposed Statement would require that the acquirer disclose "if the amounts recognized in the financial statements for the merger or acquisition have been determined only provisionally: (1) the reasons why the initial accounting for the merger or acquisition is not complete, (2) the assets acquired or the liabilities assumed for which the measurement period is still open, and (3) the nature and amount of any measurement period adjustments recognized during the reporting period."
c. End the measurement period as soon as it receives the necessary information about facts and circumstances that existed as of the acquisition date or learns the information is not obtainable. However, the measurement period should not exceed one year after the acquisition date. As in proposed Statement 141(R), the Board decided to place constraints on the period of time for which it is deemed reasonable to seek necessary information.
d. Adjust comparative information in previously issued financial statements, including any change in depreciation, amortization, or other income effect recognized as a result of completing the initial accounting. The Board

acknowledged concerns that retrospective adjustments and adjusting previously issued comparative information are more costly. However, the Board supported this presentation requirement because it would improve the quality of comparative information reported in financial statements.

Presentation

Statement of Activities

B160. This proposed Statement would require that a not-for-profit organization that recognizes a contribution received in a merger or acquisition present that contribution as a line item separate from other contributions in its statement of activities. Consistent with Statement 116 and FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* the contribution would be reported as an increase in permanently restricted net assets, temporarily restricted net assets, or unrestricted net assets depending on the type of donor-imposed restrictions assumed by the acquiring organization.

B161. The Board also decided that determining whether a contribution received in a merger or acquisition is included as part of "operations," if such a measure is reported, should be left to the discretion of the organization (or other guidance). Requiring contributions received in a merger or acquisition to be presented within operating or nonoperating classes (or other classes) would be more restrictive than the requirements of Statement 117. The Board concluded that it is clear from Statement 117 that the requirements allow flexibility in determining operating and nonoperating items, as well as other classifications, provided the measure is clear or otherwise defined.

B162. The health care Guide, however, defines a performance indicator and standardizes what is included as part of the indicator (operations) or what is excluded from the performance indicator (nonoperating income). Therefore, the Board considered whether it should provide guidance specifying whether an acquirer of a business or nonprofit activity that applies the provisions of the health care Guide should include those contributions received in the performance indicator. However, this proposed Statement does not provide presentation guidance for whether other gains or losses that arise in a merger or acquisition or that arise subsequent to a merger or acquisition should be included in the performance indicator. Those gains and losses are analogous to gains and losses that are recognized in a normal context (such as an arm's-length sale or disposal). Therefore, the existing requirements should determine their presentation.

B163. In reaching its conclusion about the presentation of a contribution received in a merger or acquisition, the Board considered whether the contribution of a business or nonprofit activity, as a whole, would meet the existing criteria in the health care Guide:

a. Paragraph 10.21c of the health care Guide requires that receipt of restricted contributions (both temporary and permanent restrictions, as defined by Statement 116) be reported separately from the performance indicator. Consistent with the health care Guide, if the donor restricts the use of the acquired business or nonprofit activity, the associated contribution received that is recognized in the merger or acquisition would be presented separately from the performance indicator.

b. Paragraph 10.21d of the health care Guide requires that contributions of long-lived assets also be reported separately from the performance indicator. The business or nonprofit activity might be viewed as long-lived and not readily convertible (that is, not likely to be converted) to cash. If that was the case, consistent with the health care Guide, the entire contribution received would be presented separately from the performance indicator.

Based on that existing guidance, the Board concluded that the contribution received in a merger or acquisition should be presented separately from the performance indicator unless the acquired business or nonprofit activity meets the criteria in paragraph 32 of Statement 144 to be classified as held for sale.

Cash Flow Statement

B164. FASB Statement No. 95, *Statement of Cash Flows*, as amended, establishes standards for providing a statement of cash flows in the general-purpose financial statement of not-for-profit organizations. It requires that organizations classify cash receipts and payments as resulting from investing, financing, and operating activities. In this proposed Statement, the Board considered whether cash inflows and outflows resulting from a merger or acquisition should be presented as an investing or financing activity. Consistent with Statement 95, a merger or acquisition that is an exchange of commensurate values generally would be reported as an investing activity to the extent of cash consideration paid. However, when the assets acquired are resources that by donor stipulation must be used for long-term purposes, some portion of the transaction might be considered a financing transaction.

B165. Paragraph 18 of Statement 95, as amended by Statement 117, states:

> Financing activities include obtaining resources from owners and providing them with a return on, and a return of, their investment; receiving restricted resources that by donor stipulation must be used for long-term purposes; borrowing money and repaying amounts borrowed, or otherwise settling the obligation; and obtaining and paying for other resources obtained from creditors on long-term credit.

B166. In this proposed Statement, the Board concluded that unlike resources that by donor stipulation must be used for long-term purposes (such as gifts restricted to creation of permanent or term endowments, gifts subject to life estates, and gifts for the purchase of long-lived assets), the cash flows associated with the merger or acquisition of a business would not be mistakenly identified by users of the financial statements as resources freely available for use. Therefore, the Board concluded that the entire portion of any net cash flow (cash paid as consideration transferred, if any, less cash of the acquiree that is acquired) from a merger or acquisition should be reported as an investing activity outflow or inflow.

Disclosures

B167. The Board used the disclosure requirements in proposed Statement 141(R) as its point of reference for formulating the disclosure requirements in this proposed Statement. The Board considered whether those disclosure requirements should be applicable to not-for-profit organizations and whether they would result in useful information for the users of those organization's financial statements.

B168. The disclosure requirements in proposed Statement 141(R) include overall objectives for the disclosure of information. Additionally, that proposed Statement specifies particular disclosures that generally would be required to meet those disclosure objectives and requires that an acquirer disclose any additional information it believes is necessary to meet those objectives. In this proposed Statement, the Board concluded that the disclosure objectives for a not-for-profit organization should be the same as those required for a business entity, to the extent that they apply. Those objectives are that the acquirer disclose information that enables users of its financial statements to evaluate:

a. The nature and financial effect of mergers and acquisitions that occur (1) during the reporting period and (2) after the balance sheet date but before the financial statements are issued (paragraph 64)
b. The financial effects of adjustments recognized in the current reporting period relating to mergers and acquisitions that were effected in the current or previous reporting periods (paragraph 69)
c. Changes in the carrying amount of goodwill during the reporting period (paragraph 71).

B169. The Board then considered whether there were any compelling differences between business entities and not-for-profit organizations that would call for any differences from the guidance for the specific disclosures that are generally required to meet the disclosure objectives in proposed Statement 141(R). No compelling differences were observed that would call for any significant differences in those disclosure requirements. However, some modifications were made for differences that originate from:

a. Proposed accounting requirements that are different. For example, this proposed Statement would not require an acquiree to measure the fair value and would require a different impairment test for a reporting unit's goodwill that is primarily supported by contributions and returns on investments.
b. Existing accounting requirements for not-for-profit organizations that are applicable to those organizations. For example, the required presentation of a statement of changes in net assets rather than an income statement.

Therefore, although the disclosure objectives would be the same for a not-for-profit organization and a business entity, there are slight differences between the prescribed disclosure requirements that exist in this proposed Statement and the requirements in proposed Statement 141(R).

Public Entity Disclosures

B170. The Board considered the potential usefulness of additional disclosure requirements for an acquirer that is a **public entity,** similar to those that would be required in paragraph 74 of proposed Statement 141(R). There are two parts to the required disclosure for acquirers that are public entities in proposed Statement 141(R): the amounts of revenue and net income of the acquiree since the acquisition date (referred to as the acquired growth disclosure) and the results of operations of the combined entity as if the acquisition had occurred at the beginning of the period (referred to as the pro forma disclosure).

B171. First, the Board considered whether it is possible for a not-for-profit organization to meet the definition of a public entity. As defined in current accounting guidance, that definition is **not** limited to business entities; it applies to any reporting entity that has certain defining characteristics. The Board concluded that disclosure requirements for public entities should apply equally to public entities that are business entities and those that are not-for-profit organizations, including those that are obligated for conduit debt. Therefore, paragraph 4(q) of this proposed Statement would define a public entity consistent with the definition used in proposed FASB Staff Position FAS 126-a, "Revision to the Definition of a Public Entity to Include an Obligor for Conduit Debt Securities." The FASB plans to issue that final FSP in the fourth quarter of 2006. The definition of a public entity may change in that final FSP.

B172. Opinion 16, as modified by FASB Statement No. 79, *Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises,* requires the pro forma disclosure by acquirers that are public entities that apply the purchase method. Paragraph 96 of that Opinion states that those entities "should include as supplemental information the following results of operations on a pro forma basis: (a) results of operations for the current period as though the companies had combined at the beginning of the period, unless the acquisition was at or near the beginning of the period and (b) results of operations for the immediately preceding period as though the companies had combined at the beginning of that period if comparative financial statements are presented." It is unclear whether a not-for-profit organization that is a public entity and that applies the purchase method of accounting prescribed in Opinion 16 currently provides the pro forma disclosure.

B173. In developing Statement 141, the Board considered eliminating the pro forma disclosures that are in paragraph 96 of Opinion 16. At that time, users of financial statements had mixed views about the benefits of that information. After considering respondents' views, the Board concluded that the pro forma disclosure requirements in Opinion 16 should be retained in Statement 141.

B174. In assessing the benefits of requiring the pro forma disclosures for not-for-profit organizations that are public entities (public not-for-profit organizations), the Board sought feedback from various users of the financial statements of those organizations. Those users generally supported requiring the pro forma disclosure. However, those users' views differed about the type of information that would be most beneficial, for example, whether the information should be provided on a historical or a forecasted basis and whether the information should be based on the statement of financial position, the statement of activities, or the statement of cash flows.

B175. The second public entity disclosure (the acquired growth disclosure) in proposed Statement 141(R) was added in response to requests from users for information that would enable them to distinguish between "organic" and acquisition-related growth. Specifically, paragraph 74(a) proposes that public business entities disclose "the amounts of revenue and net income of the acquiree since the acquisition date included in the consolidated income statement for the reporting period," if practicable. A group of users of financial statements of not-for-profit organizations was asked to consider whether that type of information also would be useful in evaluating public not-for-profit organizations. Those users said that the acquired growth disclosure could be useful by providing information to evaluate the potential future achievements of the consolidated entity.

B176. The Board believes that the disclosures of revenue growth and the ability to fund issued debt based on consolidated activity are equally important to users of the financial statements regardless of whether the entity is a not-for-profit or business entity. Therefore, the Board concluded that a public not-for-profit organization should be required to provide the same information as a public business entity, if practicable. Paragraph B189 of proposed Statement 141(R) explains the Board's rationale for providing a practical exception to the acquired growth disclosure and pro forma disclosure if obtaining that information is impracticable:

> The Board agreed with users that the information about postcombination revenues and net income of the acquiree is useful. However, for practical reasons, the Board concluded that [proposed Statement 141(R)] should provide an exception to that requirement . . . if distinguishing the postcombination results of the operations of the acquiree from those of the combined entity is impracticable. The Board also decided that in those circumstances the acquirer should disclose the fact and the reasons why it is impracticable to provide the postcombination information. The Board also decided to limit the period for that disclosure to the end of the current annual period. The Board believes that the information needed to provide this disclosure during that period generally will be available because often a short period of time is required to fully integrate an acquiree's operations with those of the acquirer. The Board also observed that the usefulness of the separate information diminishes as the operations of the acquiree are integrated with the combined entity.

B177. Additionally, to increase the consistency of application of the disclosures, the Board decided that this proposed Statement should be more explicit about the metrics on which the pro forma and acquired growth disclosures are based. Therefore, this proposed Statement would require separate disclosure of the amount of revenue, changes in unrestricted net assets, changes in temporarily restricted net assets, and changes in permanently restricted net assets for purposes of providing the public entity disclosures required in this proposed Statement.

Effective Date and Transition

B178. The Board decided that the provisions of this proposed Statement should apply prospectively. Prospective application of this proposed Statement is consistent with the transition requirements of Opinion 16, Statement 141, and proposed Statement 141(R). Statement 141 was effective upon its issuance or shortly thereafter. Consistent with the Board's reasons for rejecting retroactive application in prior pronouncements for business combinations, the Board concluded that retroactive application would be impractical and burdensome for many entities because the information needed may not exist or may no longer be obtainable.

B179. Because the Board's preference is that this proposed Statement be adopted at the same time as changes to the accounting for goodwill and other intangible assets and noncontrolling ownership interests, the Board decided that this proposed Statement should be effective as of the beginning of an annual period. The Board reached that conclusion about coordinating the effective dates for this proposed Statement and the requirements for a noncontrolling ownership interest in a subsidiary for the same reasons given in proposed Statement 141(R). Paragraph B192 of proposed Statement 141(R) explains that the Board believes that:

> . . . particular provisions in that proposed Statement [on consolidated financial statements, including accounting and reporting of noncontrolling interests in subsidiaries], which address the subsequent accounting for an acquiree in consolidated financial statements, are related to provisions in this Statement that address the initial accounting for an acquiree at the acquisition date. The Board believes that linking the timing of the changes in accounting required by these Statements will minimize disruptions to practice. As a result, both preparers and users of financial statements should benefit from such linkage.

This proposed Statement affirms the Board's belief.

B180. The transition provisions of the proposed Statement on the accounting for goodwill and other intangible assets by not-for-profit organizations also would require that its provisions be applied at the beginning of an organization's fiscal year. Like first-time adopters of Statement 142, not-for-profit organizations would cease amortizing previously recognized goodwill. One of the primary factors that led the Board to require the application of Statement 142 at the beginning of a fiscal year is that the Board believes that amortization of all previously recognized goodwill should stop within comparable annual periods following issuance of that Statement.

B181. At the time this proposed Statement and the proposed Statement on accounting for goodwill were issued, the Board estimated that those Statements would become effective for annual periods beginning after the provisions in this proposed Statement are issued as a final Statement. The Board believes that a period of approximately six months between the issuance of the final Statement and its effective date is desirable. The Board notes that the period between the issuance date and the effective date would help not-for-profit organizations to:

a. Reduce the potential for cases in which negotiations had already been ongoing, requiring a mid-deal change in accounting (that is, the elimination of the pooling method).
b. Prepare for this proposed Statement's implementation, especially for many of the smaller not-for-profit organizations that have small accounting departments with fewer employees.
c. Enlist the advice of others to assist in transactions, if needed.
d. Train staff on the accounting for those types of transactions.

B182. The effective date and timing of redeliberations for this proposed Statement are also interdependent with the Board's project on business combinations. Because this proposed Statement follows a differences-based approach (described in paragraphs B11–B19), the final issuance of the provisions in this proposed Statement likely would need to be simultaneous with or following the final issuance of proposed Statement 141(R). At the time this proposed Statement was issued, the Board's estimation of the final issuance of that Statement was for the second quarter of 2007.

B183. As in proposed Statement 141(R), the Board saw no reason to preclude the application of this proposed Statement's improvements for those entities that decided to adopt its provisions before the effective date. Therefore, the Board decided to encourage early application of the provisions in this proposed Statement and the other proposed Statement on the accounting for goodwill, as long as all of those provisions are applied at the same time.

Alternative View

B184. One Board member, for the reasons discussed in paragraphs B185–B191, has alternative views on the following proposals:

a. The required use of the acquisition method for particular mergers or acquisitions by not-for-profit organizations
b. The required use of fair value to measure and to remeasure certain items
c. The disclosure requirements that permit remeasurement gains and losses to be reported in notes to financial statements rather than requiring their separate display on the face of the statement of activities.

Those alternative views are consistent with that Board member's alternative views in proposed Statement 141(R).

Use of the Acquisition Method for Particular Mergers or Acquisitions by Not-for-Profit Organizations

B185. The Board member has significant concerns about the use of the acquisition method for particular mergers between not-for-profit organizations. In some of those transactions, no consideration is exchanged, the combining entities are of similar size, and the governing board and management of the combined entity are drawn equally from each of the combining entities. In such cases, the Board member believes that properly identifying an acquirer is an essentially futile exercise that would result in arbitrary revaluation of part of the combined entity and in an accounting treatment that is not representationally faithful of the underlying transaction. In that Board member's view, such mergers involving not-for-profit organizations do not represent the acquisition of one entity by another, but rather the creation of a new entity. Accordingly, in such cases, the Board member would prefer the use of fresh-start accounting for the entire combined entity because the Board member believes that application of the acquisition method would not faithfully reflect such combinations, as it would result in an essentially arbitrary, partial revaluation. Therefore, this Board member disagrees with the Board's tentative decision not to reconsider the alternative of the fresh-start method and this proposed Statement's tentative affirmation that would preclude the use of the fresh-start method in those circumstances (paragraphs B38–B40).

Required Use of Fair Value to Measure and to Remeasure Certain Items

B186. Consistent with proposed Statement 141(R), this proposed Statement would require (subject to limited exceptions) all assets acquired and liabilities assumed to be measured at their fair values at the acquisition date and that certain items (assets and liabilities for contingencies and contingent consideration) also be subsequently remeasured at fair value with changes in their fair values recognized in the not-for-profit organization's statement of activities.

B187. Statement 157 defines fair value as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." It adopts an exit price notion under which the objective is to estimate the price that would be received by selling an asset or paid to transfer a liability in a hypothetical exchange between marketplace participants. In the absence of actual observable exchange transactions or measures based on observable inputs and valuation techniques or models that have been demonstrated to replicate actual exchange prices, the determination of fair value under Statement 157 involves the use of various assumptions regarding hypothetical exchanges between hypothetical marketplace participants. For example, in the case of contingent consideration liabilities and liabilities for contingencies, the fair value measure should attempt to reflect the profit element and adjustment for risk relating to unobservable data that a hypothetical third party would demand to assume such obligations from the reporting entity.

B188. The definition of fair value in Statement 157 and the exit price objective underlying it are narrower and more specific than the concept of fair value in previous standards, which encompassed other measures of current value, including market-based entry values and present values of expected cash flows to the entity. The definition of fair value in Statement 157 also differs from many of the measures currently required under Statement 141 to be used in recording particular assets acquired and liabilities assumed in a business combination. Thus, while Statement 157 provides a more specific and conceptually consistent definition of fair value, the Board member questions whether that measure, as defined, would be the most appropriate one in terms of relevance and reliability for recording many of the assets acquired and liabilities assumed in a merger or acquisition. The Board member generally supports the use of fair value as defined in Statement 157 to measure most financial assets acquired and financial liabilities assumed in a merger or acquisition and for acquired assets that will be held for sale but does not support its use in measuring most other acquired assets and assumed liabilities. The Board member questions both the relevance and, in many cases, the reliability of using fair value measures as defined in Statement 157 for such items. Because, in many cases, the fair value measure will not represent what the reporting entity will do or even what it might be able to do, the Board member views such measures as artificial constructs that lack representational faithfulness with actual economic phenomena. Such measures would therefore seem to be of questionable relevance to users of financial statements in assisting them in predicting the future cash flows of the reporting entity. Additionally, they may lack verifiability and neutrality because such fair value measures may involve estimates and assumptions that are not based on actual or potential exchange transactions or on observable market inputs. Further, deriving such measures may often be operationally challenging and difficult to audit. The Board member also is concerned about the accounting gains and losses that would result from subsequent remeasurement at fair value of assets and liabilities for contingencies and contingent consideration liabilities.

B189. The Board member also notes that the subject of the appropriate measurement attribute(s) in financial reporting will be an important area of focus on the Board's project to improve its conceptual framework. Thus, in that Board member's view, both this proposed Statement and proposed Statement 141(R) seem to prejudge the outcome of these discussions. Accordingly, the Board member prefers that preacquisition contingencies continue to be accounted for in accordance with paragraphs 5 and 6 of FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises.* Fair value measurement and subsequent remeasurement of noncontractually-based and often idiosyncratic contingencies, such as those that arise from litigation, seem particularly problematic. The Board member also notes that the proposed treatment of such contingencies would be markedly different from the way conditional promises to give or to receive would be accounted for under this proposed Statement. Similarly, fair value measurement and remeasurement of contingent consideration may also be problematic in many cases and would seem to directly contradict the Board's decision in FASB Statement No. 123 (revised 2004), *Share-Based Payment*, regarding the treatment of performance conditions in measuring the value of such arrangements.

Separate Display of Remeasurement Gains and Losses

B190. In addition to the remeasurement gains and losses noted above relating to an acquiree's contingencies and an acquirer's contingent consideration arrangements, this proposed Statement also would result in a number of other potential remeasurement gains and losses that would be reported in the statement of activities. Those include gains and losses on nonmonetary assets transferred by the acquirer as part of the consideration and gains and losses on remeasuring any existing noncontrolling ownership investment of the acquirer in the acquiree. Additionally, in accordance with the Board's tentative decisions for its proposed Statement on consolidated financial statements, gains and losses would arise from remeasuring at fair value any retained noncontrolling investment arising at the time of loss of control of a subsidiary. Thus, when compared with current practice, those proposed requirements would create various new types of gains and losses in the statement of activities relating to remeasurements at fair value, thereby potentially adding to the challenges of effective communication in financial statements already posed by the mixed attribute model. While this proposed Statement, as well as Statement 157, would provide disclosure of those gains and losses in the footnotes to the financial statements, it would not require any specific display or highlighting of them on the face of the statement of activities.

B191. The Board member is concerned that the failure to require a separate display of such gains and losses on the face of the statement of activities may complicate and hinder, rather than help, financial analysis. In the Board member's view, users of financial statements have repeatedly informed the Board that they attempt to separate such items from other components of changes in net assets in performing their analyses and for valuation purposes. Furthermore, examining potential display alternatives along those lines is an important aspect of the Board's current project on financial statement presentation. Accordingly, to enhance the transparency and understandability of the statement of activities in the meantime, the Board member believes that it is important that any new standard that introduces potentially significant new fair value measurements that affect changes in net assets also should require separate display of the resulting gains and losses on the face of the statement of activities instead of just in the footnote disclosures. This might be accomplished, for example, by requiring that the aggregate gain or loss for the period resulting from such remeasurements be displayed separately on the face of the statement of activities with disclosure in the footnotes of the components of that aggregate gain or loss.

Appendix C

COMPARISON OF THE REQUIREMENTS OF THIS PROPOSED STATEMENT TO THE PRINCIPLES IN PROPOSED STATEMENT 141(R)

C1. This proposed Statement has many of the same basic requirements as proposed FASB Statement No. 141 (revised 200X), *Business Combinations*, which this proposed Statement refers to as proposed Statement 141(R). The chart compares and contrasts the main requirements of this proposed Statement and those of proposed Statement 141(R). Differences primarily result from differences in the nature of some transactions and differences in the basic organization and environment (see FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*).

	Principles in Proposed Statement 141(R)	**Related Requirements of This Proposed Statement**	**Comparison**
1.	A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses.	. . . a merger or acquisition is any event that results in the initial recognition of another business or nonprofit activity (acquiree) in the financial statements of a not-for-profit organization. Thus, any event that requires an organization to consolidate a previously unconsolidated entity by initially recognizing its net assets is a merger or acquisition. [paragraph 2]	Both proposed Statement 141(R) and this proposed Statement: a. Focus on the requisite event or transaction that gives rise to a business combination (merger or acquisition) and the application of the requirements of those Statements. b. Apply to events involving the acquisition of integrated sets of activities and assets, whether accomplished through a purchase, gift, or other means. This proposed Statement differs in that it requires the application of existing guidance for not-for-profit organizations in determining when to recognize the acquired business or nonprofit activity. In some cases, not-for-profit organizations are not consolidated when control is obtained in accordance with existing guidance.

	Principles in Proposed Statement 141(R)	Related Requirements of This Proposed Statement	Comparison
			The definition of control for business entities is based on voting rights, which is insufficient for not-for-profit organizations.
2.	All business combinations shall be accounted for by applying the acquisition method.	A not-for-profit organization shall account for a merger or acquisition by applying the acquisition method described in this Statement. [paragraph 7]	Both proposed Statement 141(R) and this proposed Statement: a. Require the application of the acquisition method b. Prohibit the use of the pooling-of-interests method. This proposed Statement's application of the acquisition method has certain exceptions to the principles that go beyond those in proposed Statement 141(R). Those exceptions result primarily from the inclusion of guidance for acquisitions that involve gifts. (See below.)
3.	An acquirer shall be identified for all business combinations.	An acquirer shall be identified for all mergers and acquisitions. [paragraph 9]	Same.
4.	The acquisition date is the date the acquirer obtains control of the acquiree.	The acquisition date is the date an acquirer obtains control of an acquiree. [paragraph 13]	Same.
5.	The acquirer shall measure the fair value of the acquiree, as a whole, as of the acquisition date. The acquirer shall measure and recognize as of the acquisition date the assets acquired and liabilities assumed as part of the business combination. Except as provided, the identifiable assets acquired and liabilities shall be	An acquirer shall measure the fair value of the consideration transferred in exchange for an acquiree, if any, as of the acquisition date. . . . [paragraph 38] Except as provided . . . an acquirer shall recognize separately from goodwill the identifiable assets acquired and liabilities assumed that compose an acquiree. [paragraph 15]	This proposed Statement is different in that it does not require certain measures that are required by proposed Statement 141(R). Those measures are the acquisition date fair value of the acquiree as a whole and the acquisition date fair value of the acquirer's interest in the acquiree. As a result, this proposed Statement may calculate goodwill differently from proposed Statement 141(R).

	Principles in Proposed Statement 141(R)	Related Requirements of This Proposed Statement	Comparison
	measured at fair value and recognized separately from goodwill.	An acquirer shall measure the identifiable assets acquired and liabilities assumed at their fair values on the acquisition date except as provided. . . . [paragraph 30]	In contrast to business combinations, some acquirers in mergers or acquisitions by not-for-profit organizations may receive either a full or a partial contribution of an acquiree. This proposed Statement is different from proposed Statement 141(R) in that it requires the recognition of those inherent contributions received, measured as the sum of the identifiable assets acquired less the sum of the consideration transferred and the liabilities assumed. Both proposed Statement 141(R) and this proposed Statement: a. Require the measurement and recognition of the identifiable assets acquired and liabilities assumed at fair value b. Provide limited exceptions to that requirement. This proposed Statement differs in that it provides an exception to the recognition principle for certain inexhaustible collection items acquired and conditional promises acquired or assumed in a merger or acquisition, consistent with FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*.
6.	The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognized at the acquisition date in accounting	The measurement period is the period after the acquisition date during which an acquirer may adjust the provisional amounts recognized at the acquisition date in accounting for a merger or acquisition. The measurement period provides	Both proposed Statement 141(R) and this proposed Statement have the same objective for the measurement period.

	Principles in Proposed Statement 141(R)	Related Requirements of This Proposed Statement	Comparison
	for a business combination. The measurement period provides the acquirer reasonable time to obtain the information necessary to identify and measure the following: a. The acquisition date fair value of the acquiree b. The acquisition date fair value of the acquirer's interest in the acquiree c. The acquisition date fair value of the consideration transferred for the acquiree d. The acquisition date values of the assets acquired and liabilities assumed recognized in accordance with this Statement.	an acquirer a reasonable amount of time to obtain the information necessary to identify and measure the following: a. The acquisition date fair value of the consideration transferred for an acquiree b. The acquisition date values of the identifiable assets acquired, liabilities assumed, and goodwill or inherent contributions received that are recognized in accordance with the requirements of this Statement. [paragraph 52]	This proposed Statement is different in that it does not require certain measures that are required by proposed Statement 141(R).
7.	The acquirer shall assess whether any portion of the transaction price (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the exchange for the acquiree. Only the consideration transferred and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree shall be included in the business combination accounting. Any portion of the transaction price or any assets acquired or liabilities assumed or	An acquirer shall assess whether any portion of the consideration transferred (payments or other arrangements) and any assets acquired or liabilities assumed or incurred are not part of the merger or acquisition. Only the consideration transferred for an acquiree and the assets acquired or liabilities assumed or incurred that are part of the merger or acquisition shall be included in the acquisition accounting. Any portion of the consideration transferred or any assets acquired or liabilities assumed or incurred that are not part of the merger or acquisition shall be accounted for separately. [paragraph 58]	Same.

	Principles in Proposed Statement 141(R)	Related Requirements of This Proposed Statement	Comparison
	incurred that are not part of the exchange for the acquiree shall be accounted for separately from the business combination.		
8.	The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of business combinations that occur: a. During the reporting period b. After the balance sheet date but before the financial statements are issued.	An acquirer shall separately disclose information that enables users of its financial statements to evaluate the nature and financial effect of mergers and acquisitions whose acquisition date is: a. During the reporting period b. After the balance sheet date but before the financial statements are issued. [paragraph 64]	Same.
9.	The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period relating to business combinations that were effected in the current or previous reporting periods.	An acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period relating to mergers and acquisitions of current or previous reporting periods. [paragraph 69]	Same.
10.	The acquirer shall disclose information that enables users of its financial statements to evaluate changes in the carrying amount of goodwill during the reporting period.	An acquirer shall disclose information that enables users of its financial statements to evaluate changes in the carrying amount of goodwill during the reporting period. [paragraph 71]	Same.

Appendix D

ACCOUNTING FOR A NONCONTROLLING OWNERSHIP INTEREST IN A SUBSIDIARY

CONTENTS

Paragraph Numbers

Appendix D

ACCOUNTING FOR A NONCONTROLLING OWNERSHIP INTEREST IN A SUBSIDIARY

Introduction

D1. This appendix provides interpretative guidance for the accounting and reporting in the consolidated financial statements of a not-for-profit organization of a noncontrolling ownership interest in a subsidiary (sometimes called noncontrolling interests or minority interests) and for the loss of control of subsidiaries.

D2. On June 30, 2005, the Board issued proposed FASB Statement, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries* (referred to as the proposed Statement on noncontrolling interests in this Statement). That proposed Statement would establish standards for the accounting and reporting of noncontrolling interests in consolidated financial statements and for the loss of control of subsidiaries. Paragraph 35 of that proposed Statement would require that the application of certain provisions by not-for-profit organizations be delayed until interpretive guidance is issued. Those provisions relate to reporting noncontrolling interests in subsidiaries, loss of control of subsidiaries, and their related disclosures. As part of its project on mergers and acquisitions by not-for-profit organizations, the Board considered how that guidance should be applied by not-for-profit organizations. This appendix provides that interpretative guidance.

D3. When the Board issues its final Statement on noncontrolling interests, it plans to remove the delay in the effective date in paragraph 35 of the proposed Statement on noncontrolling interests and incorporate the interpretative guidance that is in this appendix into its final Statement on noncontrolling interests.

Standards of Financial Accounting and Reporting

Scope

D4. A not-for-profit organization (parent) shall apply the requirements in this appendix in accounting for a noncontrolling ownership interest in the parent's consolidated financial statements. A noncontrolling ownership interest is defined as the portion of the equity (net assets or residual interest) in a subsidiary attributable to the owners of the subsidiary other than the parent and the parent's affiliates.

D5. 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.

Reporting Noncontrolling Ownership Interests in the Consolidated Statement of Financial Position

D6. Noncontrolling ownership interests in the equity (net assets) of consolidated subsidiaries shall be reported in the consolidated statement of financial position as a separate component of the appropriate class of net assets in the consolidated financial statements of a not-for-profit organization. That amount shall be clearly identified and labeled (for example, as **noncontrolling ownership interest in subsidiaries**) to distinguish it from the components of net assets of the parent, which includes the parent's controlling ownership interest in its subsidiaries. The effects of donor-imposed restrictions, if any, on a partially owned subsidiary's net assets shall be reported in accordance with FASB Statements No. 117, *Financial Statements of Not-for-Profit Organizations,* and No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations.* (Paragraphs D21–D24 provide an illustration of the reporting requirements.)

Attributing Consolidated Changes in Net Assets to the Controlling and Noncontrolling Ownership Interests

D7. Changes in net assets shall be attributed to the controlling and noncontrolling interests. That attribution shall be based on relative ownership interests unless the controlling and noncontrolling interests have entered into a contractual arrangement that requires a different attribution between them. In that case, changes in net assets shall be attributed to the controlling and noncontrolling interests based on the contractual requirements of that arrangement.

D8. Losses applicable to the controlling and noncontrolling interests in a consolidated subsidiary may exceed their interests in a subsidiary's unrestricted equity or unrestricted net assets, as defined by Statement 117. The excess, and any further losses applicable to the controlling and noncontrolling interests, shall be attributed to those interests. That is, losses applicable to the noncontrolling interest shall continue to be attributed to the noncontrolling interest even if that attribution exceeds the unrestricted equity or unrestricted net assets attributable to the noncontrolling interest.

D9. A not-for-profit health care organization that is within the scope of AICPA Audit and Accounting Guide, *Health Care Organizations*, shall report the amount of the performance indicator attributed to the controlling and noncontrolling interests based on relative ownership interests unless the controlling and noncontrolling interests have entered into a contractual arrangement that requires a different attribution between them.

Changes in Ownership Interests in a Subsidiary

D10. Once control of a subsidiary is obtained, changes in ownership interests in that subsidiary that do not result in a loss of control shall be accounted for as equity (net asset) transactions (investments by owners and distributions to owners acting in their capacity as owners). The carrying amount of the noncontrolling interest 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).[14] 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, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.*

Attributing Goodwill to a Noncontrolling Ownership Interest

D11. On the date control of a subsidiary is obtained, the noncontrolling interest in the ownership of the subsidiary's net assets shall be measured and recognized in accordance with paragraph A74(c) of this Statement. A not-for-profit organization shall only initially allocate goodwill to a noncontrolling interest in a net deficit combination.[15] If the relative ownership interests held by the controlling and noncontrolling interests in the subsidiary change, goodwill shall be reattributed between the controlling and noncontrolling interests based on the relative carrying amounts of goodwill allocated to them.

Loss of Control of a Subsidiary

D12. Control of a subsidiary may be lost if the parent or other members of the consolidated group sell their controlling financial interest in a subsidiary or through other means. Control may be lost with or without a change in absolute or relative ownership levels or as a result of a contractual agreement. Control of a subsidiary also may be lost if that subsidiary becomes subject to the control of a government, court, administrator, or regulator.

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[14]An increase in a parent's ownership interest in an investee that results in the parent obtaining control of and consolidating that investee (called an acquisition achieved in stages) is accounted for under paragraph A75 of this Statement if the investee meets this Statement's definition of a business. 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.

[15]Paragraph A74(b)(1) of this Statement requires that goodwill recognized be allocated to the controlling interest unless the combination is a net deficit combination. Therefore, the guidance in this paragraph for the attribution (and subsequent reattribution) of goodwill does not apply. Paragraph A74(b)(2) of this Statement describes how to allocate goodwill to the controlling (acquirer) and noncontrolling interests on the date control is obtained if less than 100 percent of the controlling ownership interests are acquired in a net deficit combination.

D13. If a parent loses control of a subsidiary, any gain or loss shall be recognized in the consolidated statement of changes in net assets and measured as the difference between the following:

a. The aggregate of (1) the fair value of the proceeds, if any, from the transaction that resulted in the loss of control and (2) the fair value of any retained investment in the former subsidiary at the date control is lost
b. The parent's interest in the former subsidiary's net assets at the date control is lost.

D14. If a parent loses control of a partially owned subsidiary, the noncontrolling interest's share of the carrying amount of the net assets of the former subsidiary at the date control is lost shall be derecognized against the carrying amount of the noncontrolling interest and no gain or loss shall be recognized.

D15. A parent may lose control of a subsidiary in two or more arrangements (that is, both transactions and other arrangements). Each arrangement shall be accounted for separately unless conditions indicate that they are part of a single arrangement. The presence of any one of the following factors indicates that multiple arrangements should be accounted for as a single arrangement unless it can be clearly demonstrated that such accounting would be inappropriate:

a. The arrangements are entered into at the same time or as part of a continuous sequence and in contemplation of one another.
b. The arrangements form a single arrangement that achieves, or is designed to achieve, an overall commercial effect.
c. The occurrence of one arrangement is dependent on the occurrence of another arrangement.
d. One or more of the arrangements considered on their own are not economically justified, but they are economically justified when considered together. An example is when one disposal is priced below market, compensated for by a subsequent disposal priced above market.

Disclosures

D16. A not-for-profit organization with one or more partially owned subsidiaries shall provide a schedule of changes in consolidated net assets attributable to the controlling and noncontrolling ownership interests in subsidiaries, either as a separate financial statement or in the notes to the consolidated financial statements. That schedule shall reconcile beginning and ending balances of the controlling and noncontrolling ownership interests in subsidiaries for each class of net assets for which a noncontrolling ownership interest exists at any time during the reporting period. At a minimum, such a schedule shall include:

a. A performance indicator, if the organization is within the scope of the health care Guide
b. Amounts of discontinued operations

c. Amounts of extraordinary items
d. Changes in ownership interests in a subsidiary, including investments by and distributions to noncontrolling interests acting in their capacity as owners
e. An aggregate amount of all other changes in unrestricted net assets (or other net asset classes, if restricted) for the period.

(Paragraphs D21–D24 illustrate those requirements.)

D17. A not-for-profit organization that loses control of a subsidiary shall disclose the amount of any gain or loss recognized. If that gain or loss is not separately presented on the face of the statement of activities, the caption in the statement of activities in which that gain or loss is recognized shall be disclosed. If control of a subsidiary is lost, but an investment is retained, the portion of the gain or loss related to the remeasurement of the retained investment to its fair value shall be disclosed separately from the total gain or loss recognized.

Transition and Effective Date

D18. Consistent with paragraph 76, the provisions for the accounting and reporting for noncontrolling ownership interests by not-for-profit organizations shall be effective for annual periods beginning on or after [date to be inserted after exposure].

D19. A not-for-profit organization shall apply the following provisions retrospectively:

a. The noncontrolling interest shall be reclassified to equity (net assets), separate from the parent shareholders' equity (net assets), in the consolidated statement of financial position.
b. Consolidated activities shall be attributed to the controlling and noncontrolling interests in accordance with paragraph D7 of this Statement.
c. Losses applicable to the noncontrolling interest in a subsidiary that exceed the noncontrolling interest in the equity or net assets of the subsidiary that were attributed to the controlling ownership interest in accordance with paragraph 15 of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, shall be reattributed to the controlling and noncontrolling interests in accordance with paragraph D8 of this Statement, if the entity controls the subsidiary when this Statement is applied.
d. The amount of any gains or losses recognized in the statement of activities for decreases in a parent's controlling ownership interest in a subsidiary that did not result in a loss of control of that subsidiary and the caption in the statement of activities in which that gain or loss is recognized (if not separately presented on the face of the statement of activities) shall be disclosed for all periods presented.
e. The disclosures required in paragraph D16 of this Statement shall be provided for all periods presented.
f. If control of a subsidiary was lost before this Statement is applied, the amount of any gain or loss recognized and the caption in the statement of activities in

which that gain or loss is recognized (if not separately presented on the face of the statement of activities) shall be disclosed for all periods presented.

D20. A not-for-profit organization shall not apply the following provisions retrospectively:

a. The requirements in paragraph D10 of this Statement for accounting for increases in a parent's controlling ownership interest in a subsidiary (acquisitions of noncontrolling interests). The requirements in that paragraph shall not apply to increases that occurred before this Statement is applied. If a parent's ownership interest in its subsidiary increases after this Statement is applied, that event shall be accounted for as an equity (net asset) transaction, and the values of the subsidiary's assets and liabilities in the consolidated financial statements shall not be changed.
b. The requirements in paragraphs D12–D15 of this Statement for the accounting for the loss of control of one or more subsidiaries. Any gain or loss recognized for the loss of control of one or more subsidiaries before this Statement is applied shall not be adjusted retrospectively. Also, the carrying amount of any retained investment in a former subsidiary in which control was lost before application of this Statement shall not be adjusted retrospectively.

Illustration of the Presentation Requirements

D21. Paragraphs D22–D24 provide an example of the presentation of noncontrolling interests in the consolidated financial statements of a not-for-profit organization.

D22. Formats or levels of detail other than those presented in this example may be appropriate. Shading is used to highlight certain totals that must be reported in financial statements to comply with the provisions of Statement 117. Other formats that include the required basic totals also may be used. Additionally, the consolidated financial statements of a not-for-profit parent shall report the effects of donor-imposed restrictions, if any, on a partially owned subsidiary's net assets (see paragraph D6). This example assumes no donor restrictions for the use of Subsidiary A; however, there may be circumstances in which presentation in temporarily or permanently restricted net assets is appropriate.

D23. The following example illustrates the presentation requirements in paragraph D16 for the consolidated financial statements of a not-for-profit organization for noncontrolling ownership interests in a consolidated subsidiary and subsequent changes in ownership interests of that subsidiary.

D24. Assume Organization X, the parent, controls a for-profit subsidiary (Subsidiary A) and:

a. As of January 1, 20X6, Organization X owns 80 percent of Subsidiary A.
b. On January 30, 20X7, Organization X sells a portion of its interest in Subsidiary A to a third party for cash of $17,000, reducing its interest to 70 percent. Organization X continues to control Subsidiary A after the transaction. The carrying value of the interest sold is $16,910, which includes

accumulated other comprehensive income of $1,870. This transaction is accounted for as an equity transaction in the statement of activities. (The related accumulated other comprehensive income attributable to the interest sold is reattributed to the noncontrolling interests.)

c. On July 1, 20X7, Organization X purchases a portion of the noncontrolling ownership interests in Subsidiary A from the noncontrolling shareholders. Organization X pays cash of $57,000, increasing its interest in Subsidiary A to 90 percent. The carrying value of the interest purchased is $54,900, which includes accumulated other comprehensive income of $5,400. This transaction is also accounted for as an equity transaction in the statement of activities. (The related accumulated other comprehensive income attributable to the interest purchased is reattributed to the controlling ownership interest.)

Exhibit 1

Organization X
Consolidated Statement of Financial Position
December 31

	20X7	20X6
Assets:		
Cash	$ 159,000	$ 177,500
Accounts receivable	205,000	195,000
Investments	—	112,000
Plant and equipment	1,102,500	985,250
Total assets	$1,466,500	$1,469,750
Liabilities:		
Accounts payable	$ 125,500	$ 112,500
Accrued liabilities	89,000	79,250
Pension liability	131,000	128,000
Notes payable	187,250	318,500
Total liabilities	532,750	638,250
Net Assets:		
Unrestricted net assets:		
Controlling ownership interest, including controlling ownership interest in subsidiary	**751,690**	**634,900**
Noncontrolling ownership interest in subsidiary	**32,060**	**48,600**
Total unrestricted net assets	783,750	683,500
Temporarily restricted net assets	50,000	48,000
Permanently restricted net assets	100,000	100,000
Total net assets	933,750	831,500
Total liabilities and net assets	$1,466,500	$1,469,750

Exhibit 2

Organization X
Consolidated Statement of Activities
Year Ended December 31

	20X7	**20X6**
Changes in unrestricted net assets:		
Revenues and support	$170,000	$155,000
Expenses	(31,750)	(41,000)
Net assets released from restrictions	2,000	
Excess of revenues and support over expenses[a]	140,250	114,000
Sale of subsidiary stock to noncontrolling interests[b]	**17,000**	—
Increase in subsidiary stock purchased by controlling ownership interest[b]	**(57,000)**	—
Change in net assets before effects of discontinued operations and extraordinary item, net of tax	100,250	114,000
Discontinued operations, net of tax	—	(7,000)
Extraordinary item, net of tax	—	(23,500)
Change in unrestricted net assets	100,250	83,500
Changes in temporarily restricted net assets:		
Contributions	4,000	—
Net assets released from restrictions	(2,000)	—
Change in temporarily restricted net assets	2,000	—
Change in net assets	$102,250	$ 83,500
Net assets at beginning of year	831,500	748,000
Net assets at end of year	$933,750	$831,500

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[a]Statement 117 neither encourages nor discourages additional classifications within a statement of activities of revenues, expenses, gains, and losses within classes of net assets. Therefore, a subtotal of the excess of revenues and support over expenses in the statement of activities is neither required nor prohibited.

[b]AICPA SOP 02-2, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations, and Clarification of the Performance Indicator,* requires that health care organizations exclude transactions with owners from the performance indicator in the statement of activities. For organizations other than health care organizations, the location of equity items in the presentation of the statement of activities is not specifically addressed in generally accepted accounting principles.

Exhibit 3

Organization X
Notes to Consolidated Financial Statements
Changes in Consolidated Unrestricted Net Assets Attributable to the Controlling Ownership Interest and Noncontrolling Ownership Interests in Subsidiaries

	Controlling Interest[c]	Noncontrolling Ownership Interests	Total
Balance January 1, 20X6	**$570,100**	**$29,900**	**$600,000**
Changes in net assets before effects of discontinued operations and extraordinary item, net of tax	89,200	24,800	114,000
Discontinued operations, net of tax	(5,600)	(1,400)	(7,000)
Extraordinary item, net of tax	(18,800)	(4,700)	(23,500)
Change in net assets	64,800	18,700	83,500
Balance December 31, 20X6	**634,900**	**48,600**	**683,500**
Excess of revenue and support over expenses	118,800	21,450	140,250
Sale of subsidiary stock to noncontrolling interest[d]	90	16,910	17,000
Increase in subsidiary stock purchased by controlling ownership interest[e]	(2,100)	(54,900)	(57,000)
Change in net assets	116,790	(16,540)	100,250
Balance December 31, 20X7	**$751,690**	**$32,060**	**$783,750**

[c]The controlling ownership interest includes the net assets that are controlled by Organization X, including its controlling ownership interest in Subsidiary A.

[d]Because not-for-profit organizations do not separately report other comprehensive income, the amounts presented for the sale of subsidiary stock are net of the $1,870 transfer of accumulated other comprehensive income resulting from the sale.

[e]Because not-for-profit organizations do not separately report other comprehensive income, the amounts presented for the purchase of stock by the controlling ownership interest are net of the $5,400 transfer of accumulated other comprehensive income resulting from the sale.

Alternate Presentation Exhibit 3

Organization X
Notes to Consolidated Financial Statements
Changes in Consolidated Unrestricted Net Assets Attributable to the Controlling Ownership Interest and Noncontrolling Ownership Interests in Subsidiaries

	Controlling Interest	Noncontrolling Ownership Interests	Total
Balance January 1, 20X6	**$570,100**	**$29,900**	**$600,000**
Changes in net assets before effects of discontinued operations and extraordinary item, net of tax	89,200	24,800	114,000
Discontinued operations, net of tax	(5,600)	(1,400)	(7,000)
Extraordinary item, net of tax	(18,800)	(4,700)	(23,500)
Change in net assets	64,800	18,700	83,500
Balance December 31, 20X6	**634,900**	**48,600**	**683,500**
Excess of revenue and support over expenses	118,800	21,450	140,250
Sale of subsidiary stock to noncontrolling interest:			
Carrying amount of stock sold	—	15,040	15,040
Premium received from sale of stock	1,960	—	1,960
Transfer between controlling ownership interest and noncontrolling interest resulting from sale	(1,870)	1,870	—
	90	16,910	17,000
Purchase of noncontrolling interest stock by controlling ownership interest:			
Carrying amount of stock purchased	—	(49,500)	(49,500)
Premium paid to acquire stock	(7,500)	—	(7,500)
Transfer between controlling ownership interest and noncontrolling ownership interest resulting from purchase	5,400	(5,400)	—
	(2,100)	(54,900)	(57,000)
Change in net assets	**116,790**	**(16,540)**	**100,250**
Balance December 31, 20X7	**$751,690**	**$32,060**	**$783,750**

Appendix E

AMENDMENTS TO EXISTING PRONOUNCEMENTS AND RELATED AUTHORITATIVE LITERATURE

E1. This section addresses the effect of this Statement on authoritative accounting literature included in the GAAP hierarchy discussed in AICPA Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles.

E2. Additionally, to the extent that the existing pronouncements and related authoritative literature listed in Appendixes D and E of proposed FASB Statement No. 141 (revised 200X), *Business Combinations,* and Appendixes D and E of proposed FASB Statement No. 1XX, *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*, apply to a not-for-profit organization, the amendments in those appendixes also apply to a not-for-profit organization. Those amendments would be updated to include references to this Statement, as appropriate.

Amendments to Existing Pronouncements

E3. APB Opinion No. 16, *Business Combinations,* was superseded by FASB Statement No. 141, *Business Combinations,* for all entities within the scope of Statement 141. This Statement supersedes Opinion 16 for all not-for-profit organizations.

E4. APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

a. Paragraph 4(i) is added as follows:

> A merger or acquisition accounted for by a not-for-profit organization according to the provisions of FASB Statement No. 1XA, *Not-for-Profit Organizations: Mergers and Acquisitions.*

E5. FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made,* is amended as follows:

a. Paragraph 8:

> Except as provided in paragraphs 9, ~~and~~ 11, and 13A, contributions received shall be recognized as revenues or gains in the period received and as assets, decreases of liabilities, or expenses depending on the form of the benefits received. Contributions received shall be measured at their fair values. Contributions received by not-for-profit organizations shall be reported as **restricted support** or **unrestricted support** as provided in paragraphs 14–16.

b. Paragraph 13A and the related heading are added as follows:

Contributions Received in a Merger or Acquisition by a Not-for-Profit Organization

Contributions received in a merger or acquisition by a not-for-profit organization shall not be recognized and measured in accordance with this Statement. Rather, those contributions shall be accounted for in accordance with FASB Statement No. 1XA, *Not-for-Profit Organizations: Mergers and Acquisitions.*

E6. FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* is amended as follows:

a. Paragraph 13:

A statement of financial position provided by a not-for-profit organization shall report the amounts for each of three classes of net assets—**permanently restricted net assets, temporarily restricted net assets,** and **unrestricted net assets**—based on the existence or absence of donor-imposed restrictions. Noncontrolling ownership interests in a subsidiary of a not-for-profit organization shall be reported as a separate component of net assets and shall be classified based on the existence or absence of donor-imposed restrictions.

Related Authoritative Literature

EITF Issues and FASB Staff Q&As

E7. The following table lists Emerging Issues Task Force (EITF) Issues and Topics and FASB Staff Q&As relating to mergers and acquisitions by a not-for-profit organization and indicates the status of that literature upon issuance of this Statement and the impact of this Statement on that literature (if any).

EITF Issue/ Q&A No.	Title	Description of Guidance or Issue	Effect of Statement on Q&A/ Issue No.
04-5	Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights	Paragraph 3, footnote 3, of this Issue states that the Issue's guidance applies to not-for-profit entities that are required to apply the consolidation guidance in Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* and FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries,* for their investments in partnership entities.	The guidance is unaffected by this Statement. The proposed FASB Statement on noncontrolling interests replaces ARB 51 and supersedes Statement 94 for for-profit entities. Appendix D of this Statement extends the accounting and reporting for noncontrolling interests in the proposed FASB Statement on noncontrolling interests to not-for-profit entities. Therefore, references within this Issue to ARB 51 and Statement 94 would be updated.
116/117 Question 16	Not-for-Profit Organizations: Guidance on Applying FASB Statements 116 and 117	Statement 117 requires financial statements on the basis of the entity as a whole. This question addresses whether certain related entities of not-for-profit organizations should be consolidated.	The guidance is unaffected by this Statement.

AICPA Literature

E8. The following table lists guidance issued by the AICPA relating to mergers and acquisitions by not-for-profit organizations and indicates the status of that literature upon issuance of this Statement and the impact of this Statement on that literature (if any). Decisions about whether to amend AICPA guidance are made by the FASB in conjunction with the AICPA prior to issuing the final Statement. (Note: The AICPA will make the changes until there is an FASB codification.)

AICPA Literature	Title	Analysis
SOP 94-3	*Reporting of Related Entities by Not-for-Profit Organizations*	Paragraph 5 states that not-for-profit organizations with a controlling financial interest in a for-profit entity through direct or indirect ownership of a majority voting interest in that entity should follow the guidance in ARB 51, as amended by Statement 94 and FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, in determining whether the financial position, results of operations, and cash flows of the for-profit entity should be included in the not-for-profit organization's financial statements. The proposed FASB Statement on noncontrolling interests replaces ARB 51 and supersedes Statement 94 for for-profit entities. Appendix D of this Statement extends the accounting and reporting for noncontrolling interests in the proposed FASB Statement on noncontrolling interests to not-for-profit entities. Therefore, references within this SOP to ARB 51 and Statement 94 would be updated.
AICPA Audit and Accounting Guide	*Health Care Organizations*	This Guide requires the use of either of two methods of accounting—the pooling-of-interests method and the purchase method—for mergers and acquisitions by not-for-profit organizations. This Statement requires a single method of accounting for all mergers and acquisitions by those organizations that occur after this Statement's effective date and provides guidance to apply that method. This Guide requires that the statement of operations for not-for-profit health care organizations include a performance indicator that reports results of operations and specifies the components that should be reported separately from that performance indicator. This Statement would amend those components in the Guide to clarify that any contribution received in a merger or acquisition should be presented separately from the performance indicator, unless the acquired business or nonprofit activity meets the criteria to be classified as held for sale in paragraph 32 of Statement 144. All references to APB Opinion No. 16 in this Guide will be replaced with reference to this Statement. All references to guidance in either or both *ARB 51* and

AICPA Literature	Title	Analysis
		Statement 94 in this Guide will be replaced with *proposed FASB Statement on noncontrolling interests,* which replaces ARB 51 and supersedes Statement 94 for for-profit entities. Appendix D of this Statement extends the accounting and reporting for noncontrolling interests in the proposed FASB Statement on noncontrolling interests to not-for-profit entities.
AICPA Audit and Accounting Guide	*Not-for-Profit Organizations*	This Guide requires the use of either of two methods of accounting—the pooling-of-interests method and the purchase method— for mergers and acquisitions by not-for-profit organizations. This Statement requires a single method of accounting for all mergers and acquisitions by those organizations that occur after this Statement's effective date and provides guidance to apply that method. All references to APB Opinion No. 16 in this Guide will be replaced with reference to this Statement. All references to guidance in either or both *ARB 51* and *Statement 94* in this Guide will be replaced with *proposed FASB Statement on noncontrolling interests,* which replaces ARB 51 and supersedes Statement 94 for for-profit entities. Appendix D of this Statement extends the accounting and reporting for noncontrolling interests in the proposed FASB Statement on noncontrolling interests to not-for-profit entities.