

MINUTES



To: Board Members
From: Rebecca Goodman (ext. 295)
Subject: Minutes of the January 26, 2005 Board Meeting **Date:** February 2, 2005
cc: FASB: Bielstein, Smith, Petrone, Bossio, Tamulis, Posta, Goodman, Hansen, Gerard, Todorova, Polley, Gabriele, Getz, Thompson, Sutay, Mahoney, FASB Intranet; IASB: Leisenring; GASB: Schermann

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Topic: Combinations of Not-for-Profit Organizations: (A) Partially Owned Subsidiaries and Noncontrolling Interests and (B) Goodwill Accounting Issues

Basis for Discussion: Memorandum 1 dated October 27, 2004; memorandum 2 dated October 27, 2004; memorandum 3 dated January 13, 2005; and memorandum 4 dated January 20, 2005

Length of Discussion: 9:00 to 10:00 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Schipper, Seidman, Trott, and Young

Board members absent: None

Staff in charge of topic: McIntosh

Other staff at Board table: Bielstein, Bossio, Todorova, Hansen, and Goodman

Outside participants: None

Summary of Decisions Reached:

Partially Owned Subsidiaries

The Board decided that its decisions on the accounting for the initial consolidation of a partially owned subsidiary that were developed in its project on business combinations should also apply to NFP organizations, with certain modifications. That is:

1. If an NFP organization (the NFP parent) acquires less than 100 percent of a for-profit business or NFP organization in a reciprocal transaction:
 - a. In the consolidated financial statements of the NFP parent, the partially owned subsidiary would initially be consolidated at its full fair value. If the NFP parent owned a noncontrolling equity investment in the subsidiary owned immediately before the combination transaction, that investment would be remeasured to its fair value at the acquisition date and the change in fair value recognized in the statement of activities.
 - b. The amount of any acquired goodwill allocated to the controlling ownership interest would be measured as the difference between the *fair value of the controlling ownership interest* and the *controlling interest's share in the fair value of the identifiable net assets acquired*. The *fair value of the controlling ownership interest* would be defined as the acquisition date fair values of (1) the consideration exchanged by the acquirer and (2) the acquiring entity's previous noncontrolling investment in the acquired entity.
2. If the NFP parent acquires less than 100 percent of a for-profit business or NFP organization in a nonreciprocal (or partially nonreciprocal) transaction:
 - a. In the consolidated financial statements of the NFP parent, the partially owned subsidiary would initially be consolidated at the fair value of the identifiable net assets acquired (that is, those assets and liabilities that meet the recognition requirements of the proposed Statement) plus the amount of goodwill purchased by the NFP parent. If the NFP parent owned a noncontrolling equity investment in the subsidiary owned immediately before the combination transaction, that investment would be remeasured to an amount equal to the interests' ownership share of the acquisition date fair value of the net identifiable assets acquired with a gain or loss recognized in the statement of activities.
 - b. Any purchased goodwill would be allocated to the controlling interest, except in those cases in which the fair value of the liabilities assumed in the combination exceeds the fair value of the recognized assets acquired (a net deficit combination). The goodwill recognized in a net deficit combination would be allocated between the controlling and the noncontrolling interests based on their ownership percentage.

The Board decided to include NFP organizations in the scope of the proposed Statement that will replace Accounting Research Bulletin No. 51, *Consolidated Financial Statements*. However, the application of the noncontrolling interest provisions of that proposed Statement by NFP organizations will be deferred until the Board finalizes supplemental guidance clarifying its application by NFP organizations. The Board expects to issue an Exposure Draft of that supplemental guidance at the same time that it issues an Exposure Draft on the accounting for combinations by NFP organizations. The Board reached the following decisions on the nature and extent of that supplemental guidance:

1. Consolidated financial statements of an NFP parent would present the donor-imposed restrictions on a partially owned subsidiary's net assets 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*. Noncontrolling ownership interests in consolidated subsidiaries would be presented as a separate component of the appropriate class of equity or net assets in the consolidated financial statements.
2. Losses that exceed the noncontrolling ownership interests in a subsidiary's unrestricted equity or net assets, as defined by Statement 117, would be attributed to those interests, reducing the carrying amount of those interests below zero.
3. A change in the ownership interest in a consolidated subsidiary that does not result in deconsolidation is an equity transaction that would be reported as a separate line item in the consolidated statement of activities. After such a change in ownership interests, goodwill would be reallocated between controlling and noncontrolling interests based on relative carrying amounts.
4. If there is a change in the ownership interest in a consolidated subsidiary that results in deconsolidation of that subsidiary, but the NFP parent retains an ownership interest in that subsidiary, the retained interest would be remeasured to fair value upon deconsolidation, except as follows:
 - a. If the subsidiary is a not-for-profit organization, any retained ownership interests would be remeasured to an amount that equals the sum of (1) the interests' ownership share in the deconsolidation date fair value of the subsidiary's net identifiable, recognizable assets and (2) the carrying amount of any goodwill allocated to the retained interests in accordance with the guidance for allocating goodwill upon the disposal of a portion of a reporting unit.

The Board also agreed to require the following disclosures:

1. A schedule of changes in consolidated net assets attributable to the controlling interest and noncontrolling ownership interest in subsidiaries, either as a separate financial statement or in the notes to the consolidated

financial statements. The schedule would reconcile beginning and ending balances of the controlling interest and noncontrolling ownership interest 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 would include:

- a. A performance indicator, if the organization is required to report a performance indicator by GAAP
 - b. Discontinued operations
 - c. Extraordinary items
 - d. A cumulative effect of a change in accounting principle
 - e. Changes in ownership interests in a subsidiary, including investments by and distributions to noncontrolling interests acting in their capacity as owners
 - f. All other changes in unrestricted net assets for the period.
2. Upon loss of control of a subsidiary, the NFP parent would disclose the amount of any gain or loss recognized on deconsolidation and the caption in the statement of activities that includes that gain or loss. If an entity loses control of a subsidiary but retains a noncontrolling equity investment in that entity, the NFP parent also would separately disclose the amount of any gain or loss recognized at the date of deconsolidation.

Goodwill Accounting Issues

Clarification of the reporting unit support criterion—The Board previously decided to provide NFP organizations an exception to the fair-value-based impairment test in FASB Statement No. 142, *Goodwill and Other Intangible Assets*, for any goodwill assigned to a reporting unit that is not supported primarily by fees or other charges to third parties for goods and services. The Board decided that such goodwill would be tested for impairment using a trigger-based write-off method. In response to feedback received from working group members, the Board agreed to clarify the scope of this exception by revising the wording of the criterion. Accordingly, the two-path goodwill impairment testing model would be applied as follows:

1. The fair-value-based impairment method in Statement 142 applies to goodwill assigned to a reporting unit that is not supported primarily by contributions and returns on investments.
2. The trigger-based impairment method applies to goodwill assigned to a reporting unit that is supported primarily by contributions and returns on investments.

The Board clarified that an NFP organization should consider all relevant qualitative and quantitative factors in determining whether a reporting unit is

primarily supported by contributions and returns on investment. In addition, all forms of contributed support, including contributions that are not recognized in the financial statements (such as contributed services), should be considered in the application of the support criterion.

Change in the nature of a reporting unit's primary support—The Board decided that an NFP organization should account for changes in the nature of a reporting unit's primary support as follows:

1. If a reporting unit becomes supported primarily by contributions and returns on investments, the NFP organization would consider whether the change in the nature of support indicates that the goodwill has been significantly impaired, based on the facts and circumstances existing at the date of change. If, in the organization's judgment, the goodwill has been significantly impaired, it would be written off at that date. Otherwise, as of the date of the change, the organization would identify impairment events for the prospective application of the trigger-based write-off impairment test.
2. If the nature of a reporting unit's support changes such that it is no longer primarily supported by contributions and returns on investments, the goodwill assigned to that reporting unit would be tested for impairment using the Statement 142-type test as of the date of change.
3. *Determining the date of change*—An NFP parent would evaluate the continued appropriateness of the goodwill impairment testing method each reporting period. If the reporting unit experienced a change in the nature of its support as a result of an identifiable event, the date of the event is the date the method of impairment testing would be changed. If the change in support happened gradually over time rather than upon an identifiable event, then the method of impairment testing would be changed as of the date the change is determined to be of a continuing nature. In evaluating whether the source of primary support has changed, all relevant facts and circumstances should be considered, including (but not limited to):
 - a. Duration and amount of decline or increase in percentage of contribution and investment return support
 - b. Underlying reasons for the change in support
 - c. Management's plans, reactions to the change, and expectations for the future operation of the reporting unit.

Disclosures—The Board decided that for each period for which a statement of financial position is presented, NFP organizations should disclose separately the changes in carrying amounts of goodwill for goodwill subject to the Statement 142-type fair value impairment test and for goodwill subject to the trigger-based write-off impairment test. The disclosure of changes in the carrying amount of goodwill by the impairment testing method would include disclosure of any

amounts that changed from one method to the other as a result of changes in the nature of the reporting units to which the goodwill is assigned. Goodwill impairment loss disclosures required by paragraph 47 of Statement 142 made by an NFP organization also would include which method of impairment testing was used to determine the loss.

Transition—The Board decided that for previously acquired goodwill assigned to an NFP organization's reporting units that are supported primarily by contributions and investment returns, there should be no transitional impairment test as of the beginning of the fiscal year in which the new standard is initially applied in its entirety. The impairment events that would trigger the write-off of goodwill after the adoption of the final Statement would be identified based on the facts and circumstances existing at the initial application date, with consideration given to factors that led to the original recognition of the goodwill.

Assigning assets and liabilities to reporting units—The Board clarified that the criteria in paragraph 32 of Statement 142 for assigning assets and liabilities to reporting units is not intended to require an NFP organization to determine the fair value of a reporting unit if it is supported primarily by contributions and returns on investments.

Assigning goodwill to reporting units—The Board agreed to clarify that any guidance in paragraphs 34 and 35 of Statement 142 that requires the determination of the fair value of a reporting unit would not apply to an NFP organization's assignment of goodwill to a reporting unit that is primarily supported by contributions and returns on investments.

Disposal of a part of a reporting unit—The Board decided that for the disposal of a part (that is a *combined set*) of a reporting unit that is supported primarily by contributions and returns on investments, the carrying amount of goodwill should be allocated based on specific identification of goodwill with the parts disposed of and retained, if possible. If (1) specific identification is not possible and (2) either the disposed of or retained parts of the reporting unit, or both, are primarily contribution supported on the disposal date, then the carrying amount of goodwill

should be allocated to the part of the reporting unit disposed of and the part retained based on the *relative carrying amounts* of the identifiable recognizable net assets of each part, instead of using the relative fair value method described in paragraph 39 of Statement 142.

If the retained portion of the reporting unit is supported primarily by contributions and returns on investments and the partial disposal had been identified as an impairment event when the goodwill was initially acquired, then the remaining goodwill should be written off when the disposal occurs. However, if a previously identified triggering event does not occur upon disposal, the NFP organization should review and update, based on current facts and circumstances, the events identified that would indicate significant impairment of the retained goodwill. There should be no other impairment test on the retained goodwill immediately after the disposal for this type of reporting unit.

Reorganization of reporting structure—The Board decided that when all or part of a reporting unit that is supported primarily by contributions and returns on investments is to be integrated into one or more other reporting units, at least one of which is supported primarily by contributions and investment returns, the goodwill should be reassigned based on specific identification, if possible. Otherwise, the goodwill reassignment in the circumstances described should be based on the relative carrying amounts of the identifiable recognizable net assets reassigned.

Objective of Meeting:

To develop guidance for combinations of NFP organizations for partially owned subsidiaries, noncontrolling interests, and goodwill accounting.

Matters Discussed and Decisions Reached:

Initial Consolidation of Partially Owned Subsidiaries

1. Ms. McIntosh stated that the staff recommended that NFP organizations be required to apply the guidance on accounting for the initial consolidation of a

partially owned subsidiary that was developed in the Board's project on business combinations, with some modifications for NFP subsidiaries acquired in a nonreciprocal or partially nonreciprocal transaction. Under a previous Board decision on accounting for the nonreciprocal or partially nonreciprocal acquisition of an NFP organization, goodwill would be recognized only to the extent the acquirer paid for it. That decision provided an exception to the business combination principle that the acquiree be recorded at its full fair value, including goodwill. The Board adopted that exception because of concerns about the potential difficulty of determining the fair value of an acquired NFP organization reliably, without incurring undue cost, in the absence of a market transaction. Ms. McIntosh explained that the recommended modifications to the business combinations guidance for partially owned subsidiaries would be consistent with the Board's earlier decision on how to measure the acquisition of a wholly owned NFP organization.

2. Ms. Schipper supported Ms. McIntosh's recommendations because they are consistent with both the proposed revisions to Statement 141 and the exceptions to that business combinations guidance that the Board previously decided should apply for combinations of NFP organizations.

3. Ms. Seidman noted that while the recommendations are complex on paper, they would be operationally simple to implement.

4. Mr. Batavick acknowledged the Resource Group members' extensive input on the issues discussed and thanked them for their assistance.

5. Mr. Herz asked why goodwill should be recorded in the acquisition of a net fair value deficit and why any of it should be allocated to noncontrolling ownership interests. Ms. McIntosh noted that the recognition of goodwill in a net fair value deficit acquisition is consistent with the previous Board conclusion that an NFP organization will not knowingly overpay to acquire another entity and, therefore, a net fair value deficit must imply goodwill. If an organization recorded full fair value of the identifiable assets acquired and liabilities assumed in a net deficit acquisition, it would be recording the full net deficit of the acquiree, not only the

controlling interest's deficit; therefore, the resulting goodwill should be allocated between the controlling and noncontrolling interests.

6. Mr. Trott agreed that an acquirer must have a reason to assume a net fair value deficit, which implies goodwill.

7. The Board unanimously agreed with the staff's recommendations.

Consolidation Procedures for Partially Owned Subsidiaries

8. The Board discussed the effect on NFP organizations of replacing ARB 51 with a proposed new Statement that includes the Board's consolidation procedures decisions reached during phase II of the business combinations project. The Board unanimously decided to include NFP organizations in the scope of the proposed replacement of ARB 51, but to defer the application of the noncontrolling interest provisions until supplemental guidance clarifying the application by an NFP organization could be finalized by the Board.

9. Ms. McIntosh described the staff-recommended modifications for NFP organizations to the consolidation procedures and related disclosures the Board has proposed for partially owned subsidiaries of for-profit businesses. The recommended modifications would adapt the consolidation procedures and disclosure guidance to the reporting requirements for NFP organizations provided by Statement 117. She explained that the suggested modifications to the guidance for remeasurement of a retained ownership interest upon deconsolidation of a subsidiary were intended to address the Board's concerns about the ability to determine, reliably without incurring undue cost, the fair value of an NFP organization in the absence of a market transaction.

10. Mr. Herz said that he did not like the business combinations decision that would require remeasurement of retained ownership interests upon deconsolidation. He said that it seemed like selective application of new basis accounting, and he questioned whether there would be benefits worth the cost for NFP organizations. However, he stated that he would not object to the staff's

recommended guidance for remeasurement of retained ownership interests upon deconsolidation of a subsidiary. All other Board members decided to accept the staff's recommendation.

11. The Board unanimously agreed to adopt all of the other staff-recommended guidance for the application to NFP organizations of the consolidation procedures and related disclosures the Board has proposed for partially owned subsidiaries of for-profit businesses.

Goodwill Accounting Issues

Issue 1—Application of Support Criterion

12. Ms. McIntosh said that questions have arisen about the application of the Board's previous decision to provide, for some reporting units of an NFP organization, an exception to the fair-value-based goodwill impairment test required by Statement 142. The Board had provided that exception for reporting units that are not supported primarily by fees or other charges to third parties for goods and services. For goodwill assigned to such reporting units, the Board provided an alternative impairment testing method. The support criterion was intended to identify those reporting units that would be sufficiently different than a business that their fair value might be difficult to determine reliably without incurring undue cost. The staff recommended that the Board clarify the application of the support criterion.

13. Mr. Trott said that he supported providing the fair value testing exception to reporting units that are supported primarily by contributions and returns on contributions because this would describe the difference between NFP and business operations better than the fee support criterion. As an alternative, he suggested that the support criterion include contributions and returns on investments, and not be limited to returns on contributed assets. Mr. Trott added that the support criterion should not be designed such that an investment portfolio determines whether or not an NFP organization follows the business enterprise model.

14. Ms. Schipper supported Mr. Trott's alternative suggestion. She noted that tracking investment returns on contributed assets separately from returns on other investments would be impractical. She acknowledged that the support criterion would be a rule rather than a principle but that such a rule was necessary in this instance to minimize operational complexity.

15. Ms. Seidman noted that the Board's intent at the March 17, 2003 meeting in designing a support criterion was to distinguish those entities for which it would be difficult to derive a fair value because of a lack of market transactions. Therefore, "contributions and returns on investments" rather than "fees or other charges to third parties for goods and services" would be a better support criterion to enable that distinction. She also noted that using contributions and returns on investments as the support criteria would be operationally beneficial because Statement 116 provides guidance on identifying contributions.

16. The Board unanimously decided to describe the reporting unit that qualified for the exception to the Statement 142 fair-value-based goodwill impairment test as one that is supported primarily by contributions and returns on investments. The Board decided to clarify that the determination of the nature of a reporting unit's primary support should be based on a consideration of all relevant qualitative and quantitative factors and of all forms of support, including support that is not recognized in the financial statements (such as contributed services).

Issue 2—Change in the Nature of a Reporting Unit's Primary Support

17. Ms. McIntosh said that because the Board had provided an exception to the Statement 142 fair-value-based goodwill impairment test, the Board needed to provide accounting guidance for when the nature of the reporting unit's primary support changes to the extent that goodwill assigned to that reporting unit would be subject to a different impairment test. The Board unanimously approved the

staff's recommendations for (a) accounting for the change in a reporting unit's primary support and (b) determining the date the change occurred.

18. The Board also approved the staff recommended modifications to the goodwill disclosures required by Statement 142, to provide information about the method of impairment testing applied to the NFP organization's recognized goodwill.

Issue 3—Transition

19. The Board decided to provide transition guidance for previously acquired goodwill assigned to an NFP organization's reporting units that are supported primarily by contributions and investment returns upon the initial adoption of the new NFP standard. The Board adopted the staff's recommended transition guidance.

Issue 4—Assigning Assets, Liabilities, and Goodwill to Reporting Units

20. Ms McIntosh explained that the following provisions of Statement 142 could require an entity to determine the fair value of its reporting units:

- a. Assignment of identifiable assets, liabilities, and goodwill to reporting units
- b. Reorganization of the entity's reporting structure
- c. Disposal of a part of a reporting unit.

21. The Board decided to adopt the staff's recommendations on how to modify that Statement 142 guidance so that an NFP organization would not be required to determine the fair value of a reporting unit that is supported primarily by contributions and returns on investments.

22. Mr. Herz again thanked the project Resource Group members for their assistance.

Follow-up Items:

None

General Announcements:

None