MEMORANDUM

Financial Accounting Standards Board

To: Board Members

From: Not-for-Profit Team
(Budak, 847-891-6081;
Maffei, ext. 273)

Subject: Minutes of January 29, 2003 Board Meeting

Date: January 31, 2003

cc: NFP Combinations Team, Bielstein, Smith, Leisenring, Swift, Polley, Gabriele, Sutay, Thompson, Schermann (GASB), FASB Intranet

Topic: Combinations of Not-for-Profit Organizations: Financial Statement Presentation and Goodwill

Basis for Discussion: Staff Memorandums dated January 21 and 24, 2003

Length of Discussion: Starting Time:10:30 a.m. Concluding Time:11:15 a.m.

Attendance:

Board members present:	Herz, Crooch, Foster, Schieneman, Schipper, Trott, and Wulff
Board members absent:	None
IASB Liaison present:	Leisenring
Staff in charge of topic:	Budak
Other staff at Board table:	Bielstein, Bossio, Cropsey, and Maffei

Summary for ACTION ALERT:

The Board discussed issues related to the financial statement presentation of acquisitions by not-for-profit organizations. It decided that acquisition transactions should be shown as follows in the statement of activities (All decisions were unanimous):

- The contribution resulting from a nonreciprocal combination transaction should be reported in the statement of activities as a line item separate from other contributions. The contribution should be reported as increases in permanently restricted net assets, temporarily restricted net assets, and unrestricted net assets depending on the type of donor-imposed restrictions assumed by the acquiring organization.
- Limitations placed on net assets by the governing board of an entity acquired in a nonreciprocal combination should be reported as donor-imposed restrictions only if those limitations are (a) imposed as conditions of the combination transaction, (b) are irrevocable, and (c) are not self-imposed. Generally, limitations imposed by the governing board of an acquired entity as a condition of the combination should be deemed self-imposed if members of the governing board of the acquired entity make up a significant portion of the governing board of the combined organization. Limitations placed by the governing board of an acquired entity as a condition of the combination should be deemed not self-imposed if the acquired entity was only a portion of another entity and that other entity continues to survive as an unaffiliated entity. Limitations on the acquired net assets that are placed by the governing board of the acquiring entity should not be reported as donor-imposed restrictions.
- An acquiring organization should not apply the reporting exception in paragraph 14 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*. Instead, an acquiring organization should report its assumption of fiduciary responsibilities for the restricted net assets of the acquired entity separately from any expiration of those restrictions that occurs after the date of acquisition and before the end of the reporting period.
- For reciprocal combinations, an acquiring organization should report changes in net assets that result from its assumption of fiduciary responsibilities for the restricted net assets of the acquired entity in the statement of activities as a reclassification in a line item separate from other reclassifications.

The Board decided that acquisition transactions should be shown as follows in the statement of cash flows:

- A nonreciprocal combination in which no consideration is exchanged should be reported as a noncash activity in accordance with paragraph 32 of FASB Statement No. 95, *Statement of Cash Flows*. If cash is received as one of the assets acquired in the nonreciprocal combination, it should be reported as an investing activity inflow.
- The net cash outflow for a reciprocal combination should be reported as an investing activity outflow.
- If the combination transaction is in part a purchase and in part a contribution, the net cash outflow should be reported as an investing activity outflow and the noncash portion should be reported as a noncash activity in accordance with paragraph 32 of Statement 95.

The Board also reconsidered its decision of August 23, 2000 about accounting for contingent consideration. It decided that contingent consideration should be reported as proposed in the guidance developed in the Purchase Method Procedures project. That is, in general:

- Contingent consideration should be reported at the fair value at the date of acquisition.
- Subsequent changes in the fair value of liabilities for contingent consideration arrangements should be reported on the statement of activities.

The staff also reported to the Board the working group's reactions to the two alternatives for reporting goodwill subsequent to acquisition that were discussed at the December 18, 2002 Board meeting. The staff did not request any decisions with respect to goodwill. The Board plans to continue its discussion of goodwill at the February 26, 2003 Board meeting.

Matters Discussed and Decisions Reached:

Reporting In the Statement of Activities

The Board reached the decisions reported in the Action Alert section.

Ms. Budak stated that the staff had planned to discuss with the Board whether the classification of unrestricted net assets would change if a not-for-profit organization is acquired by an organization with a broader mission. However, she explained that the staff was unable to reach contacts in the attorney general offices, and plans to address that issue at a later date.

The staff initially suggested four examples as further explanation of the Board's decision about whether limitations placed by the governing board on the net assets transferred to the acquiring organization were restrictions. The Board decided that three of them should be included in the proposed standards, and those three are included in the Action Alert announcement of the Board's decision. The fourth example was:

> In contrast, limitations placed by a governing board of the acquired entity as a condition of the combination shall be deemed not self-imposed if a significant portion of the members of that governing board do not survive as members of the governing body of the combined organization.

Board members generally stated that that item is unnecessary because it is simply the converse of the first item. Ms. Schipper stated that the items should not be labeled examples in the proposed Statement.

Reporting In the Statement of Cash Flows

The Board reached the decisions reported in the Action Alert section.

Some Board members noted the unusual result of recording a cash inflow if cash is one of the assets acquired in a nonreciprocal combination in which no consideration is exchanged, but stated that they agree with the reasoning behind the accounting that causes that result.

Contingent Consideration

The staff suggested that the Board reconsider previous decisions made relating to the accounting for contingent consideration exchanged in combination of not-for-profits in light of more recent decisions made in the Purchase Method Procedures project. The Board agreed that there is not sufficient reason to deviate from the guidance for business combinations on this issue, and that guidance for not-for-profit organizations should be consistent with the decisions made in the Purchase Method Procedures project.

Accounting for Goodwill Subsequent to Acquisition

Ms. Budak reported to the Board on the working group's reactions to the two alternatives for reporting goodwill subsequent to acquisition that were discussed at the December 18, 2002 Board meeting. She explained that during two conference calls, working group members generally supported Alternative B, which requires a Statement 142-type impairment test if the fair value of a reporting unit can be measured with sufficient reliability. Some working group members expressed concern over the use of fair value estimates for recognition and subsequent measurement of goodwill if the marketplace in which the fair values were determined includes prices that would be paid by business enterprises.

Mr. Foster questioned whether the working group members participating in the conference calls fully understand the requirements for determining fair value, noting that some participants' comments refer to an entity-specific value, which is not fair value. Ms. Schipper stated that the participants referred to fair value in a specific component of a marketplace, which is different from an entity-specific value.

Ms. Budak also reported that most working group members who participated in the two calls generally acknowledged and accepted the inconsistency of using the fair value of reporting units to determine impairment of goodwill and not using fair value of the entity as a whole to report the contribution in a nonreciprocal combination. They did not offer conceptual arguments in support of that inconsistency. In addition she said that the working group members agreed that the reporting unit level of account could be used by not-for-profit organizations in most circumstances.

Ms. Budak stated that the staff plans to prepare a comprehensive comparison of the goodwill recognition alternatives considered to date, and will present that comparison for Board consideration at the February 26, 2003 Board meeting.

Follow-up Items:

- The staff will contact the Attorney General's office for information about the classification of unrestricted net assets of a not-for-profit organization that is acquired by an organization with a broader mission.

- Mr. Wulff asked the staff to bring back to the Board the question of whether or not to include "self-sustaining" in the definition of an activity. Mr. Wulff said that the definition of self-sustaining that he intends differs from that used in Concepts Statement No. 6 in that he would include contributions and endowment income when determining whether an activity was self-sustaining.

General Announcements:

None