MINUTES

Financial Accounting Standards Board

To: Board Members

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

Subject: Minutes of March 17, 2003 Board Meeting **Date:** March 21, 2003

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

Topic: Combinations of Not-for-Profit Organizations: Goodwill

Basis for Discussion: Staff Memorandum dated March 6, 2003

Length of Discussion: 3:30 p.m. to 4:15 p.m.

Attendance:

Board members present:	Herz, Crooch, Schipper, Trott, Wulff (by phone)
Board members absent:	Foster, Scheineman
Staff in charge of topic:	Budak
Other staff at Board table:	Bielstein, Bossio, Cropsey, McIntosh, and Maffei

Summary for ACTION ALERT:

The Board continued its discussion of initial recognition of and subsequent accounting for goodwill acquired in a combination of two or more not-for-profit organizations.

The Board decided on a two-path method of accounting for goodwill subsequent to acquisition.

1. Reporting units primarily supported by fees or other charges to third parties for goods and services would test goodwill for impairment using

the fair value method required by FASB Statement No. 142, *Goodwill and Other Intangible Assets*.

2. Reporting units not primarily supported by fees or other charges to third parties would test goodwill for impairment using a trigger-based approach that writes off goodwill in its entirety if certain triggering events occur. At the date of acquisition, the acquiring organization would identify the reasons goodwill arose in the transaction and determine triggering events related to those reasons that indicate that goodwill is significantly impaired. The Board decided that examples would be provided to help acquiring organizations identify appropriate triggering events.

The Board also decided that organizations that follow the second path should disclose the reasons goodwill arose in the transaction and the triggering events that would result in a write-off of goodwill.

The Board reaffirmed its decision made at the May 17, 2000 and June 7, 2000 Board meetings that goodwill should be recognized in nonreciprocal combinations only to the extent that the fair value of the liabilities assumed exceeds the fair value of the assets acquired (that is, the amount of the net deficit acquired).

The Board directed the staff to begin drafting an Exposure Draft of its decisions in this project.

<u>Matters Discussed and Decisions Reached</u>:

Recognition of Goodwill Subsequent to Acquisition

All Board members present favored a two-path method for testing goodwill for impairment with the first path requiring application of the goodwill impairment test described in paragraphs 19–22 of FASB Statement No. 142, *Goodwill and Other Intangible Assets*. Ms. Schipper noted that the differences-based approach of this project leads her to support a two-path method.

The Board members present also agreed that the criterion for determining whether an organization should apply the Statement 142-type test should be based upon whether the organization is primarily supported by fees or other charges to third parties for goods and services. Some Board members noted that a not-for-profit organization that is not primarily supported by fees is sufficiently different from a business enterprise to justify a departure from the guidance for business enterprises. Ms. Schipper stated that a criterion based upon whether the assets and liabilities of the acquired entity can be measured with sufficient reliability without undue cost and effort would be too subjective to provide a meaningful distinction. Mr. Trott said that a fee-based reporting unit should use a reference market that includes business enterprises for determination of the reporting unit's fair value in the Statement 142-type impairment test.

For organizations not applying the Statement 142-type test (that is, organizations taking the second path), three Board members (Herz, Schipper, Trott) favored a complete write-off of goodwill upon the occurrence of certain trigger events. Those Board members generally considered the trigger-based write-off to be more representationally faithful than a write-off immediately after the acquisition. Mr. Herz stated that an immediate write-off as the second path would provide an incentive for some organizations to develop reasons to apply that path of the test.

Mr. Crooch stated that he would support a decision to require the two-path method with the trigger-based write-off, but that his preference is to require the immediate write-off for organizations not applying the Statement 142-type test. Mr. Wulff stated that he prefers the two-path method with the immediate write-off because there is little or no value added by the trigger-based approach, but he would not object to the adoption of a trigger-based path. Mr. Herz reported that Mr. Foster had told him that under no circumstance would he support a conclusion that included the immediate write-off of goodwill.

Recognition of Goodwill at Date of Acquisition

The Board then revisited its previous decisions that in a nonreciprocal combination the acquirer should record the following:

a) Goodwill for the excess of the fair value of liabilities assumed over the fair value of identifiable assets acquired

b) A contribution for the excess of the fair value of identifiable assets acquired over the fair value of liabilities assumed.

The Board members present reaffirmed the previous decision that goodwill should be recorded when the acquiring organization assumes a net deficit.

The Board next considered whether an organization acquired in a nonreciprocal combination should be recorded based on the fair value of the entity rather than net fair value of the assets acquired and liabilities assumed. Mr. Trott stated that acquired organizations that are primarily supported by fees should follow the guidance similar to business enterprises, and that the fair value of the organization should be used to recognize the contribution if the organization was primarily supported by fees. No Board members present objected to that conclusion.

Ms. Budak introduced the following example involving a nonreciprocal combination of a fee-supported organization in which a net deficit is assumed: The fair value of the identifiable assets acquired is $1000, and the fair value of the liabilities assumed is $1200. The estimated fair value of the acquired entity is negative $100 (that is, the fair value of the assets acquired including goodwill is $1100). She asked if goodwill should be measured based on (a) the fair value of the organization, which would result in goodwill of $100 with an immediate write-off to expense of $100 or (b) the fair value of the deficit assumed, which would result in goodwill of $200.

Mr. Trott noted that the issue was whether primacy in measurement should be placed on whether (a) the combination is nonreciprocal, or (b) the reporting unit is primarily supported by fees or other charges to third parties. Some Board members stated that the estimated fair value of the organization would have to be challenged to determine whether the acquiring organization overpaid. Mr. Crooch stated that he believed this situation would be extremely rare. Mr. Herz suggested that the fair value of the liabilities assumed could be regarded as consideration given since the acquiring organization agreed to assume the net deficit. The staff pointed out that this situation is similar in some ways to the issues in the purchase method procedures project about potential overpayment and underpayment.

The Board members present then reversed the decision of a few moments earlier and reaffirmed the June 2000 decision that nonreciprocal combinations should be recorded based on the net fair value of the identifiable assets acquired and liabilities assumed; that is, goodwill would not be recorded unless the acquiring organization assumed a net deficit.

Follow-up Items:

The staff is to begin drafting an Exposure Draft based on the existing decisions made in this project.

General Announcements:

None.