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# Current Valuation Issues

## STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 164, *Not-for-Profit Entities: Mergers and Acquisitions*

### Industry Focus: Public Broadcasting and Not-for-Profit Media

Overview

The Financial Accounting Standards Board ("FASB") issued SFAS 164 to clarify the information presented in the financial statements of a not-for-profit entity when the not-for-profit entity has been involved in a merger or acquisition.[1] The statement defines what constitutes a merger and acquisition and the method of accounting required for the combination. The effective date of SFAS 164 is December 15, 2009.

Key Issues

1. The method of accounting for not-for-profit entities varies depending upon whether a transaction is treated as a merger or acquisition.

2. In an acquisition, not-for-profit entities will have to determine the fair value of the acquired assets and assumed liabilities. For the broadcasting industry this may include valuing items not previously recognized on the books such as employment agreements, sponsorship contracts and relationships, trademarks and trade names, program contracts, network affiliations, programming, and FCC licenses.

3. In an acquisition, goodwill or contribution received shall be recognized and measured if it involves a not-for-profit entity that is predominantly supported

[1] SFAS 141(R), *Business Combinations,* provides this guidance for a business combination in the for-profit sector.

by fees for services, such as nonprofit hospitals, rather than by contributions or investment returns.

4. Certain not-for-profit entities involved in acquisitions will have to test goodwill and intangible assets without determinable lives on a regular basis, similar to the provisions outlined in SFAS 142 which applies to for-profit businesses.

## Mergers

A merger is defined as an event when two or more not-for-profit entities enter into a combination or transaction and give up control to form a new entity.

In a merger, the not-for-profit entity shall use the carryover method of accounting to recognize the assets and liabilities in the financial statements. In the carryover method, the assets and liabilities of the merger entities are combined based upon book values. There are no new assets or liabilities created in the transaction. No changes to asset and liability classifications of the combining entities are made unless the merger changes the category of a contract or there are consistency issues with accounting policies.

The merger standards are effective on the day of the transaction occurring on or after December 15, 2009.

## Acquisitions

An acquisition is defined as a transaction where a not-for-profit entity gains control of one or more other not-for-profit entities. In an acquisition, the acquisition method, similar to FAS 141(R) regarding for-profit businesses, requires measurement of the fair value of identifiable assets (except goodwill), liabilities assumed, and any non-controlling interests. The identification of acquired assets and assumed liabilities may include items that were not carried on the books of the acquired entity. Certain valuable media related intangible assets that are often created internally and do not initially appear on the seller's balance sheet may include customer or client relationships, sponsorship contracts, network affiliations, FCC licenses, and programming assets.

The value of acquired assets, assumed liabilities, and any non-controlling interests will be based upon the fair value of the items as of the acquisition date. For not-for-profit entities, there are a few exceptions to the general recognition and measurement principles:

1. Donor Relationships – These relationships should not be valued separately from goodwill.

2. Collections – If a not-for-profit entity has not capitalized its collections (artwork, photographs, recordings, etc.), the collections should not be separately identified as an asset.

3. Conditional Promises to Give – Guidance to the acquirer is provided in SFAS 116 (Paragraphs 22 and 23), whereby any conditions of promise or transfer of assets has to be substantially met.

4. Assets and Liabilities Arising from Contingencies – Any assets or assumed liabilities arising from contingencies that can be measured at fair value as of the acquisition date shall be recognized. In addition, if it is probable that certain future events will occur which give rise to those assets and liabilities and their value can be reasonably estimated, then those items shall be recognized and measured. If neither of the above conditions are met, the assets and liabilities arising from contingencies shall not be recognized at the time of the acquisition.(See Bond & Pecaro's white paper on SFAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies.)*

5. Income Taxes – Any deferred tax asset or liability assumed in the transaction shall be recognized consistent with SFAS 109, *Accounting for Income Taxes* and FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes*.

6. Employee Benefits – Any asset or liability associated with employee benefits shall be recognized according to GAAP.

7. Indemnification Assets – An indemnification by the seller of the not-for-profit acquirer shall be recognized and valued at fair value.

8. Reacquired Rights – Reacquired rights shall be recognized and accounted for at fair value based upon the remaining contract term.

9. Assets held for Sale – For-sale assets are recognized at fair value less the cost to dispose.

<u>Consideration</u>

In an acquisition of a not-for-profit, the fair value of the consideration transferred is equal to the fair value of the assets transferred and liabilities incurred by the acquirer. Any asset or liability that arises from a contingency arrangement as part of the consideration will be included in the fair value of the consideration assuming adequate information is available during the measurement period.[2]

## Goodwill

The treatment of acquired goodwill is predicated upon whether the acquired not-for-profit entity is expected to be supported primarily by contributions and returns on investments.

Goodwill can be recognized if the entity is not predominantly supported by contributions and returns on investments. The value of goodwill is based upon the sum of the consideration transferred (fair value of assets transferred and liabilities assumed), the fair value of any noncontrolling interests, the fair value of any previously held equity interest in the seller, less the net assets acquired and liabilities assumed.[3]

Goodwill is not recognized if a not-for-profit entity receives most of its support from contributions and investment returns. The acquirer should apply any excess purchase price as a charge to its statement of activities at the time of the close date.

## SFAS 142

Not-for-profit entities will be required to adhere to SFAS 142 requirements for goodwill and other intangible assets acquired in a transaction beginning December 15, 2009. Consideration needs to have to be given to what constitutes a reporting unit.

This requirement is different for not-for-profit entities predominately supported by donations and internal investment returns. For these entities, if any goodwill was assumed in the transaction, goodwill needs to be written off as a charge to the statement of activities. However, the useful lives of any intangible assets that were previously recognized in APB Opinion No. 16, *Business Combinations*, other than goodwill, need to be reassessed. For these entities, any indefinite lived assets will be subject to impairment testing.

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2 The measurement period ends no later than one year from the acquisition date.

3 If the net assets acquired and liabilities assumed exceed the consideration, the excess amount is recognized as a credit in the statement of activities.

For all other not-for-profit entities, goodwill for each reporting unit shall be analyzed for impairment according to the requirements of paragraphs 55-58 of SFAS 142. In addition, the entities will have to periodically test the value of intangible assets with indefinite lives for impairment.

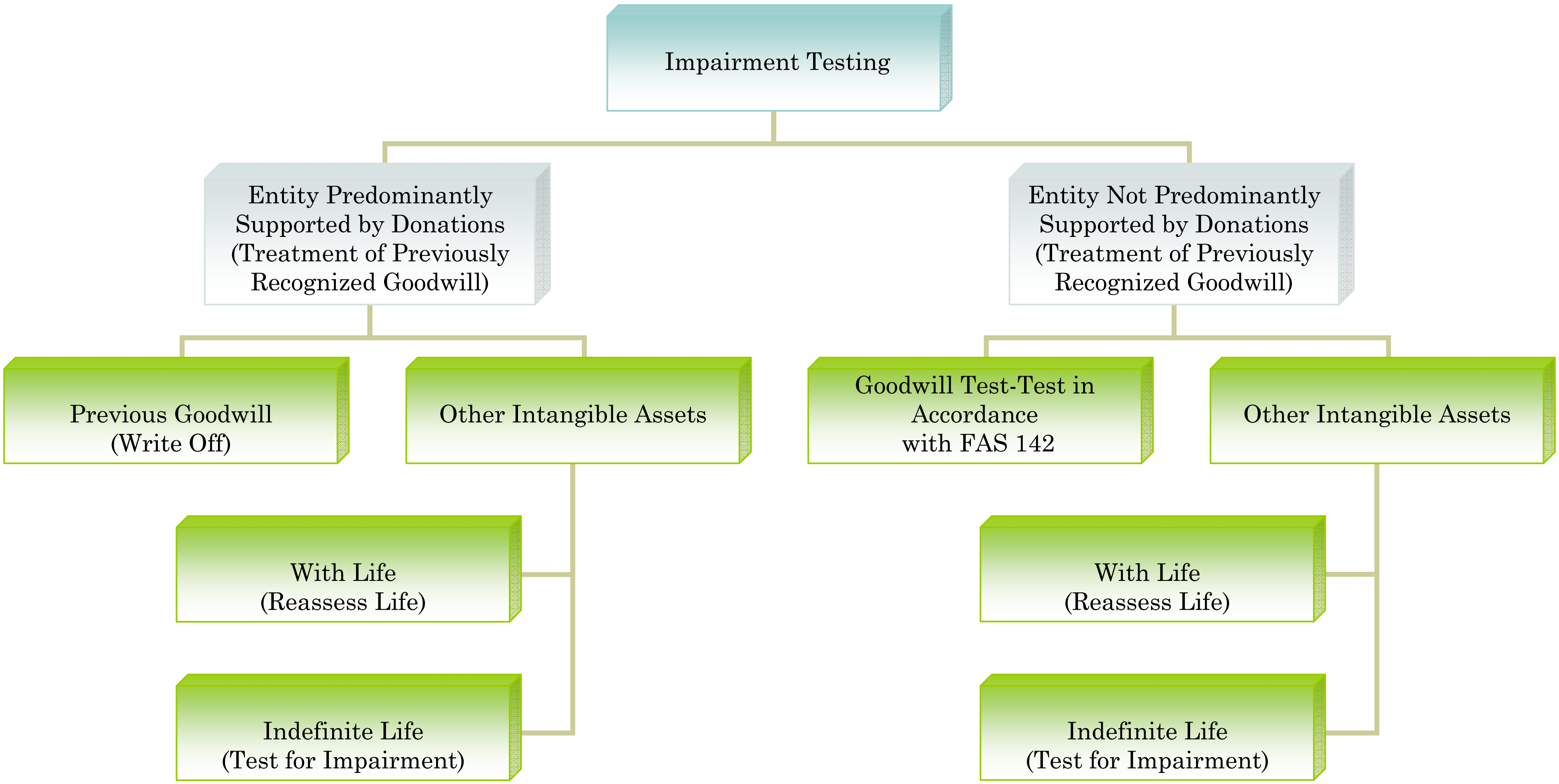
For public broadcasters, the primary and most valuable identifiable intangible asset is usually a station's FCC License. Under the new requirements, the value of the FCC license will have to be tested annually or when a major economic or financial event occurs that would warrant a change in the value of the license. Given the changes in fair value requirements dictated by SFAS 157, *Fair Value Measurements*, and the fact that broadcast FCC licenses do not change hands frequently as raw licenses (FCC licenses are almost invariably sold as part of an operating station) it is particularly important to give careful consideration to the inputs and assumptions used in valuation models to assess the value of the license. The valuation of FCC licenses for not-for-profit entities raises difficult questions given that the entities are not driven by cash flow goals in their mission statements. Questions to consider in the analysis may include, what is the appropriate level of sponsorships and expenses to allow the entity to achieve its overall non-profit goals? If an income method is an appropriate form of measurement, what is the cost of capital in the not-for-profit marketplace? Is the income method even a valid technique to apply to the assets of a non-profit organization?

## Conclusion

The issuance of SFAS 164 significantly changes the reporting requirements of not-for-profit entities, particularly in the case of acquisitions. For many deals, acquired assets and assumed liabilities have to be recognized and measured at fair value at the time of acquisition. Treatment of goodwill will depend upon how the entity is predominantly supported. Application of SFAS 142 rules may apply that require periodic testing of the entity's goodwill and intangible assets for potential impairment. The impact is particularly significant in industries such as public broadcasting where a large part of the value is contained in intangible assets.

## <u>Appendix A</u>

FAS 164, Not-For-Profit Entities
Impairment Testing

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