Combinations by Not-for-Profit Organizations — Background Information and Basis for Conclusions

Section 4449

Foreword

In March 2021, the Accounting Standards Board (AcSB) released COMBINATIONS BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4449 in Part III of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for these standards.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1101 in Part III of the Handbook. These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

March 2021

INTRODUCTION

1 This document summarizes the Accounting Standards Board's (AcSB) key considerations in reaching its conclusions in developing COMBINATIONS BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4449. This document also sets out the reasons the Board undertook the project to develop this material, the process of research and deliberation, the key decisions made and the principal reasons for adopting the positions taken and rejecting others. Individual Board members gave some factors greater weight than other ones.

2 Nothing in this document is to be taken as overriding the requirements of Part III of the CPA Canada Handbook – Accounting. However, the discussion may help readers understand how the AcSB reached its conclusions in developing the Sections and the Board's intent with respect to interpretation and application of the standard.

BACKGROUND

3 Stakeholders, including members of the AcSB's Not-for-Profit Advisory Committee (the Advisory Committee), informed the Board that due to increased competitiveness for funding and pressures to reduce costs, not-for-profit organizations (NFPOs) consider organizational changes and collaborations. This has led to an increase in the number of combinations that have occurred in this sector in recent years.

4 As no guidance existed in Part III of the CPA Handbook – Accounting on how to account for a combination by an NFPO, diversity in practice emerged including using:

(a) different frameworks;

(b) multiple frameworks for the same transaction; and

(c) guidance that was superseded.

5 In June 2018, the AcSB approved a project to explore the accounting for the initial measurement of a combination.

6 From November 2018 to January 2019, the AcSB developed criteria to determine whether a combination should be accounted for as a merger or an acquisition. These criteria were applied against different types of NFPO combinations and, in limited circumstances, to private enterprise combinations that exhibited similar characteristics to an NFPO combination. As a result of this testing, the Board determined that the proposed criteria could not be applied to such a wide range of combinations. Therefore, the Board limited the scope of its project to private NFPO combinations.

7 In January 2020, the AcSB issued its Exposure Draft, "Combinations – Initial Measurement and Related Disclosures." In developing the proposals, the Board considered the feedback of its Advisory Committee, other private sector NFPO stakeholders and participants in its field testing of the draft proposals. The Advisory Committee includes auditors, preparers and financial statement users, with a range of backgrounds and experience from across Canada. Members include representatives from organizations of differing sizes and in a variety of industries; some organizations provide benefit to individuals and society and others serve the public.

8 The AcSB received 10 comment letters and heard from 22 stakeholders at virtual roundtables from across Canada. Respondents, including roundtable participants, generally supported the Board's proposals to establish criteria to distinguish whether a combination should be accounted for as a merger or acquisition. However, respondents provided additional comments suggesting changes to some of the proposals. The specific issues addressed in this project, including the comments received on the Exposure Draft and any changes made in response to those comments, are highlighted in the subsequent sections.

EFFECTS ANALYSIS

9 In developing this standard, the AcSB considered the consequences of adopting it relative to the objective of financial statements and the benefit versus cost constraint. As described in FINANCIAL STATEMENT CONCEPTS FOR NOT-

FOR-PROFIT ORGANIZATIONS, paragraph 1001.12, "The objective of financial statements is to communicate information that is useful to members, contributors, creditors and other users ('users') in making their resource allocation decisions and / or assessing management stewardship."

10 The AcSB is committed to updating accounting standards for NFPOs, as necessary, to ensure these standards continue to meet the needs of private sector NFPO financial statement users. In executing on this commitment, the Board seeks to understand the differing needs of these users.

11 Many stakeholders advised the AcSB that there is significant diversity in practice regarding the accounting for combinations in the not-for-profit sector. While most combinations are accounted for as mergers, this conclusion is arrived at using guidance from other standards. This results in differing measurement and disclosure requirements being applied to communicate the details of the combination in the financial statements. This standard seeks to reduce that diversity by providing a model for determining whether a combination is a merger or an acquisition through a set of criteria as well as guidance on how to apply merger or acquisition accounting.

12 The AcSB acknowledges that reducing this diversity will result in a change in practice for some entities going forward. Recognizing this, the Board decided the standard will apply on a prospective basis to eliminate the requirement to restate previous combinations. In addition, the Board thinks, based on the criteria, many private NFPO combinations will continue to be accounted for as mergers.

13 A primary benefit of the new standard is an improvement in the comparability of financial reporting by applying the same guidance across all private NFPO combinations. The AcSB acknowledges that in situations in which a combination is an acquisition, additional costs will be incurred to value the assets and liabilities acquired and to have these valuations audited. However, in the case that the criteria require a combination to be accounted for as an acquisition, the Board thinks applying the acquisition method will provide more decision-useful information to financial statement users than if the combination were accounted for as a merger. Additionally, as many combinations will continue to be accounted for as mergers, these costs are unlikely to affect most organizations.

SCOPE

14 The AcSB conducted extensive research to understand the characteristics of different types of NFPO combinations and how frequently they occur. These included:

(a) combinations of two or more unrelated NFPOs;

(b) combinations of two or more related NFPOs;

(c) an NFPO acquiring a for-profit enterprise;

(d) an NFPO being contributed a for-profit enterprise;

(e) the purchase of a group of assets that do not constitute an NFPO; and

(f) two NFPOs combining to form a joint venture.

15 The AcSB considered whether the standard should scope in all of the above types of transactions. Based on its research and on its Advisory Committee's advice, the Board observed that guidance is already available in other Parts of the Handbook for NFPO combinations except combinations of related or unrelated NFPOs. For example, in the rare event that an NFPO acquires a for-profit enterprise, the Board thought BUSINESS COMBINATIONS, Section 1582 in Part II of the Handbook, should apply. The rationale is that the acquisition of a for-profit enterprise is similar whether the acquirer is an NFPO or another for-profit enterprise. As such, consistent with the purpose of Part III standards, the transaction is not unique to NFPOs and the guidance in Part II should be used.

16 The Exposure Draft proposed limiting the scope of Section 4449 to a combination of two or more NFPOs while directing stakeholders to existing guidance to account for other types of combinations as follows:

(a) the acquisition of a for-profit enterprise by a not-for-profit organization (see BUSINESS COMBINATIONS, Section 1582 in Part II of the Handbook);

(b) a contribution of a for-profit enterprise to a not-for-profit organization (see CONTRIBUTIONS – REVENUE RECOGNITION, Section 4410);

(c) a contribution of cash or other assets, which do not constitute a not-for-profit organization, to a not-for-profit organization (see CONTRIBUTIONS – REVENUE RECOGNITION, Section 4410); or

(d) the formation of a joint venture (see REPORTING CONTROLLED AND RELATED ENTITIES BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4450).

17 Some respondents to the Exposure Draft noted that, in the case of a contributed for-profit enterprise, Section 4410 only addresses accounting for contributed assets. Since a contributed for-profit enterprise will often include liabilities, the proposals did not address which standard applies to account for the liabilities.

18 The AcSB considered this feedback and the advice of its Advisory Committee on this issue. The Board discussed:

(a) an option to add guidance to Section 4410;

(b) a reference to Section 1582 in Part II; or

(c) a general reference to apply the relevant standards to measure liabilities assumed in a contributed for-profit enterprise.

19 The AcSB decided to reference Section 1582, as comprehensive guidance already exists in this standard to account for different types of liabilities in a for-profit enterprise. In addition, in the rare circumstances in which the liabilities assumed exceed the assets contributed in the for-profit enterprise, Section 1582 would provide guidance to account for the difference as goodwill. Whereas, if the assets contributed exceeded the liabilities assumed, Section 4410 would provide guidance to account for the difference as a contribution.

20 Some respondents to the Exposure Draft also noted that the standard should be applied universally to all NFPO combinations, including those between related parties. These respondents highlighted that while some related party combinations exhibit characteristics similar to combinations between unrelated parties, others did not. Examples provided were a parent amalgamating with a controlled subsidiary or similar combinations between NFPOs under common control. The respondents noted that acquisition accounting could result in the value of the assets and liabilities to be bumped up as fair value measurement is required. This would not provide decision-useful information to the users of the financial statements, such as donors or the Board of the controlling NFPOs, because nothing is changing for the underlying group of NFPOs.

21 The AcSB agreed with these comments and decided to provide an exception from applying the criteria to determine if the combination should be accounted for as a merger or acquisition. The standard requires that all NFPOs under common control apply merger accounting in all circumstances. The Board also considered whether this exception should be applied to all forms of related party combinations. The Board decided that such an exception could have unintended consequences and that the combination criteria should be applied to other related party combinations. For example, if combining NFPOs are related because they have one or more common board members, the acquisition method might still be appropriate and provide the most decision-useful information. Therefore, the Board decided to limit the exception to combinations of NFPOs under common control only.

DEFINITIONS

22 The AcSB proposed defining NFPOs in the Exposure Draft as "entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. A not-for-profit organization's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization." This definition is also found in paragraph 3(c) of the Preface to the CPA Canada Handbook – Accounting.

23 Some respondents to the Exposure Draft asked the AcSB to expand on the definition or provide application guidance to help distinguish a combination of NFPOs from an acquisition of assets that do not constitute an NFPO. These respondents recommended adding guidance, such as that in Section 1582 in Part II of the Handbook, to distinguish a business from a basket of assets. Some respondents referred to the term "entities" in the definition and questioned whether an NFPO must be a standalone legal entity rather than a division of an organization to be considered an NFPO.

24 The AcSB discussed this feedback from respondents and thought the definition of an NFPO has the detail necessary to distinguish an NFPO from a basket of assets. For example, the definition references "entities…organized and operated exclusively for…." The reference to "entities" does not imply only legal entities but can apply to any group of assets that are organized and operated for non-profit purposes. This contrasts with a single asset or a basket of assets that are not used cohesively to operate non-profit activities.

25 Based on its deliberations, the AcSB decided expanding the definition or providing application guidance was not necessary. The Board encourages stakeholders to review all of the facts and circumstances involved in any combinations they encounter.

DISTINGUISHING BETWEEN A MERGER AND AN ACQUISITION

26 Five criteria must all be met for a combination to be accounted for as a merger.

Criterion 1 – No party is characterized as the acquirer or acquiree

27 The AcSB's research prior to the Exposure Draft suggested that it was rare for either party in an NFPO combination to be characterized as the acquirer or acquiree. In fact, it was viewed negatively by NFPOs to be characterized as the acquiree in a combination as this could have adverse effects on its reputation with its own stakeholders, such as donors. However, in circumstances where one party is characterized as the acquirer, this is a clear indication of an acquisition.

28 Some respondents to the Exposure Draft and participants at the roundtable discussions questioned the application of this criterion. These stakeholders asked whether it was public statements (press releases, website postings, etc.), internal documents (Board minutes, legal documents, etc.) or a combination of both that should be used to determine whether this criterion is met. The respondents pointed to Illustrative Example 2 in the Exposure Draft, which used a newspaper advertisement as the only reason for this criterion being met.

29 The AcSB deliberated this feedback and thought that all forms of communication were relevant in determining whether this criterion is met. This includes both internal and external communications. However, the Board thought that confusion arose from how the rationale for meeting this criterion was explained in Illustrative Example 2 rather than from the criterion itself. Therefore, the Board revised the rationale in the Illustrative Example to "Although the form of the arrangement is through University A acquiring the assets and operations of University B, neither party is portrayed as the acquirer or acquiree internally by management or the Board or publicly to donors or other stakeholders, including in the full-page newspaper advertisement 'It's all ABout the future! Universities join hands for a better tomorrow.'"

Criterion 2 – Those charged with governance participate in determining the terms of the combination

30 The AcSB thinks that for a combination to be accounted for as a merger, it is essential that both parties participate in determining the terms of the combination. A key outcome of that participation is the establishment of the governance and management structures and the selection of management.

31 Some members of the Advisory Committee and participants in the AcSB's field testing of the criteria prior to the Exposure Draft, questioned whether the intent of the combining organizations and their relative size should be factors in this criterion. This feedback was raised again by respondents to the Exposure Draft. The Board deliberated this feedback before and after the Exposure Draft and concluded that while the intent of the combining organizations and their size can be factors, it is ultimately the terms of the agreement and how those terms were generated that indicate whether the combination is a merger or an acquisition.

32 For example, consider a large NFPO and a small NFPO that want to combine their operations. If prior to the combination, mutually agreeable terms are established for the combined organization with participation from both parties, the transaction exhibits the elements of a merger. If during the same negotiations, one party influences the decision-making process to the disadvantage of the other party, the other party can exit negotiations. Therefore, the transaction still exhibits the characteristics of a merger. However, if during those negotiations one of the NFPOs is disadvantaged in the negotiations due to factors outside its control and is compelled to accept the disadvantageous terms, the transaction exhibits the elements of an acquisition. In all these cases, the intent of the parties is characterized in the terms of the agreement and the agreement indicates whether the transaction is a merger or an acquisition.

33 Some respondents to the Exposure Draft questioned how this criterion could fail because any combining organization would participate when they sign the combination agreement. One respondent recommended the AcSB should require consensus of all parties involved to meet this criterion. The Board discussed this feedback and after considering the advice of its Advisory Committee concluded that consensus is not always achieved from representatives of all parties involved in a combination. However, a lack of consensus does not mean that an acquisition has occurred. For example, if one board member from one of the NFPOs combining disagrees with the terms of a combination, it does not mean that an acquisition has occurred.

34 The AcSB notes that the procedural action of signing a combination agreement does not imply participation in the negotiations that led to that agreement. For example, in situations of financial duress or legislation requiring one NFPO to combine with another, the parties may sign an agreement. However, the party under financial duress or the party compelled by legislation to combine has no ability to negotiate terms and would not meet this criterion. In addition, the criterion requires establishment of the management and governance structures which demonstrates participation from all parties to the combination.

35 After considering the feedback in totality, the AcSB decided not to amend this criterion. The Board directs stakeholders to the illustrative examples for additional context on the application of this criterion.

Criterion 3 – Consideration flowing to a third party

36 The AcSB decided that if any consideration flows to a third party, a benefit has been conferred from the combination and, therefore, that combination should be accounted for as an acquisition.

37 Prior to the Exposure Draft, the Advisory Committee questioned whether transaction costs, including severance costs, are a form of consideration flowing to a third party. The AcSB considered this feedback and recognized that transaction costs are an integral part of many combination arrangements. However, it thinks these costs are not a distinguishing factor in whether a combination should be accounted for as a merger or an acquisition. Therefore, the Board proposed, and stakeholders agreed, that such costs are not a form of consideration flowing to a third party.

38 Some respondents questioned what constitutes consideration in a combination. For example, whether the assumption of debt of one party by the reporting entity should be viewed as consideration. Alternatively, if the settlement of debt upon a combination would be viewed as consideration flowing to a third-party lender. Additionally, if the combination triggers the repayment of contributions because of funding terms, whether that would be consideration flowing to a third party. Some stakeholders cited the proposed Illustrative Example 3 where members of one non-profit golf course pay the outstanding debt of a golf course it was acquiring, and this payment is considered consideration to a third party.

39 The AcSB discussed these examples and reiterated that this criterion identifies situations where a third party is financially bettered directly from a combination. During its research phase, the Board thought this was a distinguishing factor between a merger or acquisition and maintains this view. The Board thinks the criterion itself communicates this intent but has added context to Illustrative Example 3 in the standard to address the application concerns stakeholders raised.

Criterion 4 – Purposes of the combining NFPOs is encompassed

40 Another factor the AcSB thinks is important in distinguishing a merger from an acquisition is that the combined organization encompasses the purpose of the combining organizations. The Board acknowledges that some changes to the purposes of the combining organizations is likely. However, more than a small change to the purpose is an indicator of an acquisition.

41 For example, NFPO A and NFPO B decide to combine. During the combination negotiations, aspects of NFPO B's purpose are removed from the collective purpose of the combined organization. This will result in a change to the service(s) being provided to NFPO B's stakeholders. This change in the purpose is an indicator that NFPO A's rationale

for combining is to acquire and continue some aspects of NFPO B while discontinuing others. Further, if more than a small change to NFPO B's purpose occurs, it will result in the combined comparative balances of the legacy organizations not being comparative due to the resulting change in operations. As a result, the Board decided that more than a small change to the purpose of either of the combining organizations indicates an acquisition.

42 All respondents to the Exposure Draft and all participants at the roundtable discussions agreed with this criterion as proposed. Therefore, there were no changes made to the criterion in the standard.

Criterion 5 – No significant decline in the client communities served

43 The last criterion the AcSB thinks distinguishes a merger from an acquisition is if there is a decline in the client communities served by the combined organization at the combination date. The Board's initial view was that any change in the client communities served is an indicator of an acquisition.

44 However, feedback from field-test participants and the Advisory Committee prior to the Exposure Draft was that combinations often result in an expansion of the client communities NFPOs serve. This expansion can occur on the combination date or soon after and is often a driver for NFPO mergers. For example, NFPO A and NFPO B both want to expand the client communities they serve. The initial cost of pursuing that expansion has limited their ability to expand. However, by combining their resources and operations, they are collectively able to expand the client communities they serve without significantly affecting their ongoing activities.

45 Alternatively, a reduction in the client communities is a clearer indicator that an NFPO is being acquired. The acquirer in these combinations only intends to purchase certain aspects of the acquiree. As such, these combinations will manifest in situations where some of the acquiree's programs are reduced immediately on combination and, as a result, the client communities they serve. Further, in these situations, applying acquisition accounting provides more decision-useful information as the combined results of the legacy organizations is not comparable to the combined entity as it serves a smaller client community overall. Therefore, the AcSB decided to limit this criterion to only situations where the client communities served are reduced because of a combination.

46 Respondents to the Exposure Draft and participants at the roundtable discussions questioned whether a combination of two or more NFPOs is accounted for as a merger or acquisition if all parties to the combination reduce their client communities. An example of this could occur if two financially distressed NFPOs combine and both reduced the client communities they served to remain sustainable.

47 The AcSB discussed this feedback and agreed with stakeholders that an indicator for an acquisition is when one or more but not all the parties combining experience a reduction in the client communities served. Therefore, the Board revised this criterion to articulate that if all the combining organizations reduce the client communities they serve, this criterion is met. Alternatively, if only one or more but not all the combining parties have a reduction in client communities they serve, this criterion fails.

48 Some respondents to the Exposure Draft also questioned whether reductions in programming by an NFPO results in this criterion failing. For example, if two non-profit daycare centres combine and one reduces service to an age group, would that be a reduction in client communities served. The AcSB discussed this feedback and reiterated that it was the action of reducing client communities that failed this criterion rather than a reduction in programming. This is clarified in Illustrative Example 4, which involves the acquisition of one clothing bank by another. In this example, the acquiree has a decline in the programs they run as well as a closure of all the clothing banks in the suburb in which it operates. The example demonstrates that the closure of all the clothing banks in the suburb is what results in the criterion failing, rather than the reduction in the programs.

Should the guidance default to merger accounting?

49 Participants in the field test and some members of the Advisory Committee suggested a default position to merger accounting should exist for NFPO combinations. The rationale for this recommendation was that most NFPO combinations are intended to be mergers.

50 The AcSB considered this view and performed additional consultations in this area prior to the Exposure Draft. The Board heard that while most NFPO combinations would more appropriately be accounted for as mergers, the substance of some transactions recognizes an acquirer, even if it is not communicated publicly.

51 The AcSB deliberated the options and decided that each combination needs to be evaluated with criteria to determine whether the transaction should be accounted for as a merger or an acquisition. The Board sought feedback through its Exposure Draft on the proposals to ensure the guidance was clear and concise, and, therefore, no default position was necessary.

52 Some respondents to the Exposure Draft encouraged the AcSB to reconsider that a default position to merger should be taken in the standard. Some respondents also suggested that the proposed guidance created a default position of acquisition accounting.

53 The AcSB discussed this feedback and reiterates that the substance of a combination determines whether a transaction should be accounted for as a merger or acquisition. As such, no default position exists in the standard.

ACCOUNTING FOR A COMBINATION AS A MERGER

54 The AcSB considered the following sources of guidance as reference material when deciding on the accounting for a merger:

(a) U.K. general accepted accounting practices (GAAP): Statements of Recommended Practice and Financial Reporting Standard 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland;*

(b) U.S. GAAP: Financial Accounting Standard 164, *Not-for-Profit Entities: Mergers and Acquisitions;* and

(c) Superseded Canadian GAAP: BUSINESS COMBINATIONS, Section 1590 (superseded Section in Part V of the Handbook).

Recognition

55 The sources of guidance from U.K., U.S. and Canadian GAAP provide two approaches for applying merger accounting.

56 Under the first approach, the aggregation of assets, liabilities and funds of the combining entities are presented as though the entities have always been combined. The combined entity presents comparative information showing the aggregated results for the prior period.

57 Under the second approach, the entities are not assumed to have always been combined. The combination date is presumed to be the inception date of the combined entity as the combination date is when the new reporting entity has been formed. The assets and liabilities recognized in the separate financial statements of the merging entities are aggregated as of the combination date and no historical information is available as the merged entity did not exist prior to the merger date.

58 Based on the AcSB's research and advice from its Advisory Committee, the Board understands that most combinations of NFPOs in Canada do not result in the formation of a new entity. For example, in the case of charities, the registration number of one of the combining organizations is retained and the other organization is rolled into it. Considering this advice, regardless of the method used to effect the combination, the Board decided on the approach for recognition requiring the aggregation of assets, liabilities and funds of the combining entities and presentation as though they have always been part of the same entity. The guidance requires the combined entity to present comparative information showing the aggregated results for the prior period as if the entities have always been combined. The Board thinks providing historical information will be helpful to financial statement users to assess the effects of the combination.

Measurement

59 While the recognition principles for merger accounting varies in different jurisdictions, the measurement principle remains the same. Assets, liabilities and fund balances are measured in the combined entity at the carrying amount in the accounts of the entities combining. Consistent with these principles, the standard requires measurement of the assets, liabilities and fund balances at their carrying amount.

60 An additional requirement is to apply uniform accounting policies and to make retrospective adjustments to achieve uniform accounting policies in the combined entity for the comparative period. The AcSB thinks that it is essential to provide prior year financial information that is comparative for the benefit of financial statement users to assess the effects of the combination.

61 The AcSB made one exception to the retroactive application of uniform accounting policies in paragraph 4449.12 In situations in which one or more of the combining organizations applied the size exemptions in TANGIBLE CAPITAL ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4433, and INTANGIBLE ASSETS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4434, for the recognition of capital assets and intangible assets before the combination, but no longer meet the exception after combining, the Board proposed uniform accounting policies for the recognition of capital assets and intangible assets apply on a prospective basis.

62 This exception provides relief and cost savings for the combining organizations from having to re-recognize capital assets and intangible assets that have already been expensed prior to the merger. The Board was interested in stakeholder views about whether an option should be provided to apply uniform accounting policies for the recognition of capital assets and intangible assets on a retroactive basis and asked a question on this in this Exposure Draft.

63 Several stakeholders recommended an option to apply uniform accounting policies prospectively or retroactively be provided when the size exemption to recognize capital assets or intangible assets was applied prior to the combination. The AcSB, therefore, added this option in the standard.

Disclosure

64 The AcSB considered the extent of disclosure requirements needed for mergers to ensure that financial statement users received decision-useful information. Given the accounting for mergers requires the measurement of assets, liabilities and fund balances on a retrospective basis at the carrying amount, it could be difficult for users to distinguish the effects of the merger as it relates to each of the combining organizations.

65 Therefore, the AcSB proposed disclosure requirements that enable users of the financial statements to evaluate the nature and financial effect of a combination as it relates to the current year and the prior year financials of the combining entities.

66 Some respondents to the Exposure Draft noted that the disclosure requirements for mergers were identical for combinations that occurred during the fiscal year of the combining entities or combinations which occurred after year-end. These respondents noted that the combined entity would not be formed until after the combination occurred and the disclosures would be required on the standalone financial statements of each combining NFPO. The AcSB considered this feedback and separated the disclosure requirements for combinations occurring during the year and after

year-end. The Board also reduced the disclosure requirements for combinations that occurred after the year-end of the combining NFPOs.

ACCOUNTING FOR A COMBINATION AS AN ACQUISITION

67 The AcSB requires the acquisition method be applied for combinations that fail any of the five criteria in paragraph 4449.07. The Board thinks the acquisition method, as detailed in BUSINESS COMBINATIONS, Section 1582 in Part II of the Handbook, applies to NFPO acquisitions with some exceptions for the unique nature of NFPOs. When the Board reviewed the guidance in Section 1582 as it related to the acquisition of an NFPO by another NFPO, it decided there were enough distinct characteristics for NFPOs to provide specific acquisition guidance in the standard.

Choice to disclose controlled not-for-profit subsidiaries

68 NFPOs have the option to either consolidate acquired NFPOs or to apply disclosure only in accordance with Section 4450.

69 The AcSB debated whether NFPOs that will disclose the acquiree subsequent to acquisition should be required to recognize at fair value the acquired assets and liabilities. During these discussions, the Board also considered the existing disclosure requirements for the controlled subsidiary in Section 4450.

70 The AcSB decided that these disclosure requirements provide adequate information to financial statement users about the resources of the controlled subsidiary without the need to apply the acquisition method. As such, the Board decided that the costs of applying acquisition accounting in this situation outweigh the benefits. Therefore, the acquisition method will not apply when a controlled subsidiary is disclosed. Instead, specific disclosures are required to highlight the combination transaction and provide incremental information that can benefit financial statement users.

71 Some respondents to the Exposure Draft recommended the AcSB require NFPOs that intend to apply the disclosure only method for acquirees, to disclose the fair value of assets and liabilities of the acquiree. The Board considered this feedback and decided that the costs of determining the fair value outweigh the benefits of this information. Therefore, the Board decided not to require this disclosure in the standard.

Applying the acquisition method

72 As mentioned above, the AcSB thinks the requirements in Section 1582 are relevant unless circumstances that are distinct to NFPOs justify a departure from that guidance. The standard requires four steps to apply the acquisition method:

(a) Identify the acquirer.

(b) Determine the combination date.

(c) Recognize and measure the identifiable assets acquired and liabilities assumed.

(d) Recognize and measure the excess consideration transferred or a bargain purchase.

Identifying the acquirer

73 The standard directs stakeholders to guidance in Section 4450 for how to identify the acquirer. The AcSB thinks applying this existing guidance, rather than duplicating it in this proposed standard, in conjunction with the criteria for distinguishing between when merger or acquisition accounting applies is sufficient to determine the acquirer.

Determining the combination date

74 The standard for determining the combination date is generally consistent with the guidance in Section 1582 as the AcSB did not identify anything unique for NFPOs that would warrant a different combination date.

Recognizing and measuring the identifiable assets acquired and liabilities assumed

Recognition

75 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in Section 1001 at the combination date.

76 The acquirer's application of the recognition principle and conditions may result in recognizing some assets and liabilities that the acquiree had not previously recognized as assets and liabilities in its financial statements. For example, the acquirer recognizes the acquired identifiable intangible assets, such as a brand name, license or patent, that the acquiree did not recognize as assets in its financial statements because it developed them internally and charged the related costs to expense.

77 The AcSB deliberated the treatment of favourable and unfavourable lease arrangements based on its Advisory Committee's feedback. The Board thinks that a favourable lease arrangement meets the definition of an asset as it does provide a benefit to the acquirer and an unfavourable lease arrangement meets the definition of a liability and should be accounted for as such in an acquisition.

Measurement

78 Consistent with the guidance in Section 1582, the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.

79 The AcSB also deliberated whether application of the recognition principle could result in derecognizing assets and liabilities that the acquiree has recognized. The Board focused on deferred contributions and deferred capital contributions to assess whether these meet the definition of a liability in Section 1001. The Board considered the different views expressed in its Contributions and Financial Statement Concepts projects and did not conclude on whether deferred contributions and deferred capital contributions meet the definition of a liability. The Board will

continue these deliberations in the Contributions and Financial Statement Concepts projects and seek stakeholder views on whether these deferred balances meet the definition of a liability through those projects.

80 The AcSB then considered what the fair value of a deferred contribution or a deferred capital contribution is when these balances exist in the acquiree. The Board concluded that the fair value of deferred balances could be affected by the restrictions and refundability of the contribution and whether the amounts have been expended or not. For example, the fair value of deferred capital contributions related to amounts that have yet to be expended and have no refundability could equal the carrying amount in the accounts of the acquiree. However, if the deferred capital contribution balance relates to the unamortized portion of the related capital asset(s), the fair value may be less than the carrying amount or nil as there is no obligation associated with this liability. Alternatively, if the deferred capital contribution balance relates to the unamortized portion of a capital asset and the contribution was conditional on the asset being used for the duration of its useful life, the fair value may exceed the carrying amount.

81 The AcSB considered if a practical expedient could be provided for deferred contributions and deferred capital contributions to be valued at the acquisition-date carrying amount. However, the Board decided to propose no explicit guidance in the Exposure Draft. Instead the Board thinks stakeholders should apply their judgment given the facts and circumstances surrounding the contributions to determine the fair value of these deferred balances. The Board also asked questions about the judgments stakeholders anticipate applying to determine the fair value of deferred balances, what they think the fair value should be and if additional guidance is necessary.

82 Most stakeholders recommended that the AcSB provide some guidance on how to determine the fair value of deferred balances. However, recommendations on what this guidance should be varied widely. The Board discussed this feedback and considered the advice of its Advisory Committee on this issue. The Board deliberated the nature of these deferred balances and how they can vary based on the facts and circumstances as stated earlier. In addition, the Board considered the possible effect its ongoing Contributions project could have on any guidance issued in the combinations standard. The Board, therefore, decided not to provide guidance on how to determine the fair value of deferred balances and thinks that stakeholders can apply the same principles used to fair value liabilities assumed to deferred balances in the acquiree.

Exceptions to the recognition principle

Donor or member relationships

83 In reviewing the exceptions to the recognition principle in Section 1582, the AcSB identified donor and member relationships that are unique to NFPOs. Donor and member relationships differ from customer relationships that typically arise through contractual rights. The Board thinks that estimating the fair value of acquired donor and member relationships would be difficult and costly. Therefore, requiring acquirers to do so would not meet a reasonable cost-benefit test. As such, the standard states that an acquirer does not recognize donor or member relationships, such as donor lists, of the acquiree.

Exceptions to the measurement principle

Collections

84 COLLECTIONS HELD BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4441, requires collections to be recorded on the statement of financial position at either cost or nominal value. As an accounting policy choice exists, the AcSB thinks that requiring the fair value for collections is not cost-beneficial in all circumstances. Therefore, the acquirer shall recognize the acquiree's collections based on the acquirer's accounting policy choice of either cost or nominal value.

85 Some respondents to the Exposure Draft recommended the AcSB clarify whether cost is:

(a) the purchase price of the items the acquiree paid;

(b) the collection's fair value at the time of contribution to the acquiree;

(c) the fair value of the collection at the date of acquisition; or

(d) a nominal value.

86 The AcSB discussed this recommendation in the context of the existing guidance in Section 4441. The Board determined that the acquisition-date fair value rather than the acquirees purchase cost or the acquirees contribution date fair value provide users of the financial statements with the most relevant information as it would reflect the fair value when the acquisition occurs. Therefore, the standard clarifies that collections are recorded at either the acquirers' acquisition-date fair value or a nominal value.

Tangible capital assets and intangible capital assets

87 Currently, NFPOs with revenues less than $500,000 are permitted to limit the application of Section 4433 and Section 4434. Note that the AcSB plans to re-examine these exemptions in its Contributions project.

88 Once the acquisition occurs, the $500,000 threshold may be exceeded, and the exemptions will no longer be applicable. In that case, the standard requires the acquiree's assets be recognized at their fair values as at the acquisition date. If the threshold has not been exceeded, the exemption is still applicable, and the acquirer does not need to remeasure the capital assets and intangible assets acquired at fair value on the acquisition date.

89 Prior to the Exposure Draft, the AcSB deliberated extensively on the appropriate accounting for capital assets and intangible assets given the current exemption. The Board reiterated that the exemptions were put in place to assist very small organizations with their accounting. If the $500,000 threshold is exceeded, these entities should not be permitted any further relief from providing the accounting requirements that the remaining NFPOs must apply. In the case of the acquisition method, the fair value of the capital and intangible assets provides beneficial information to the financial statement users.

90 In the Exposure Draft, the AcSB proposed that an acquirer should assess the average annual revenues of the acquisition year and the prior year as if the entities had always been combined. If this results in the average annual revenues exceeding the $500,000 threshold, the reporting entity must recognize the capital assets and intangibles of the acquiree at fair value. If the threshold is not exceeded, the reporting entity can continue to use the exemption.

91 Some respondents to the Exposure Draft commented that the proposals would be onerous for small enterprises to apply because the proposals added a step of aggregating the revenues of the entities as if they were always combined. This step was not required for the financial statements. Therefore, these respondents proposed alternatives to estimate whether the combined organization would exceed the $500,000 revenue threshold.

92 The AcSB considered the alternatives and decided to require a simplified model to determine whether the threshold had been exceeded. The standard requires an acquirer to assess whether the $500,000 revenue threshold has been exceeded by aggregating the acquirers' prior year's revenues and the acquiree's prior year's revenues. If the total for the year exceeds the $500,000 revenue threshold, the assets acquired should be recognized and measured at fair value. If not, the reporting entity can continue to apply the recognition and measurement exemption and defer to the guidance in Sections 4433 and 4434 going forward. The Board thinks this simplification will provide relief for smaller NFPOs that apply the recognition exemptions for capital assets and intangible assets.

Exceptions to the recognition and measurement principles

93 The AcSB identified areas in Section 1582 that were removed from the standard because they are not relevant to the acquisition of two or more NFPOs:

(a) Financial instruments classified in accordance with FINANCIAL INSTRUMENTS, Section 3856 in Part II of the Handbook. This reference was made for the designation of a derivative instrument as a hedging instrument. Stakeholders have indicated to the Board that the use of hedge accounting by NFPOs is rare. However, in limited circumstances when combining NFPOs apply hedge accounting, the recognition principle in paragraph 4449.27 (similar to paragraph 1582.16) provides direction.

(b) Any future income taxes arising in accordance with INCOME TAXES, Section 3465. Future income taxes are not applicable to NFPOs as they are generally tax-exempt entities.

(c) Share-based awards reported in accordance with STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS, Section 3870. Since there are no stocks or shares in NFPOs, this concept is not applicable to NFPOs.

(d) Reacquired rights. On its Advisory Committee's advice, reacquired rights are not applicable to NFPOs.

(e) Contingent consideration. The Board understands that contingent consideration is uncommon in NFPO acquisitions, which is why it has been excluded. The Board asked a question in the Exposure Draft about the frequency of contingent consideration in NFPO combinations. The feedback from respondents indicated that contingent consideration is not contemplated in NFPO combinations.

(f) A business combination achieved in stages or achieved without the transfer of consideration (i.e., through the acquisition of equity interests). Equity interests are not relevant to NFPOs. Therefore, this guidance is not applicable.

Excess of consideration transferred or a bargain purchase

94 Based on the research conducted, including feedback from its Advisory Committee, the AcSB thinks that based on the nature of the combination between two or more NFPOs, any excess of consideration transferred recognized as goodwill or a bargain purchase does not provide additional insight to financial statement users. Therefore, the Exposure Draft proposed guidance requiring the reporting entity to do either of the following:

(a) In the case of excess of consideration transferred, an expense is recognized and presented separately in the statement of operations on the combination date.

(b) In the case of a bargain purchase, a gain is recognized and presented separately in the statement of operations on the combination date.

95 Some respondents to the Exposure Draft raised concerns that a surplus created from a combination could negatively affect donor perception of the NFPO and, in some cases, could trigger refundability of certain contributions.

96 The AcSB considered this feedback and, on the advice of its Advisory Committee, decided to require the difference between the consideration transferred and the net assets acquired to be recognized in the statement of changes in net assets instead of the statement of operations. The Board, however, was concerned about whether financial statements users would be able to identify the difference between the consideration transferred and the net assets. Therefore, the

Board added a disclosure requirement to identify the amount of the difference and where it was recorded in the financial statements.

Disclosure

97 The disclosure requirements remain consistent with Section 1582 with one additional disclosure. The AcSB agreed with feedback from its Advisory Committee that including the reason for the acquisition for NFPOs is relevant information for financial statement users as acquisitions are not common for NFPOs. Excluding it would only result in users having to ask the question of management.

EFFECTIVE DATE AND TRANSITION

98 Selecting an effective date for amendments is an important step in the AcSB's due process. The Board proposed an effective date of fiscal years beginning on or after January 1, 2022, with earlier application permitted. The Board thought this will provide NFPOs sufficient time to implement the proposals.

99 Some stakeholders recommended the AcSB defer the effective date by one year to fiscal years beginning on or after January 1, 2023, due to the continuing effects of COVID-19. The Board discussed this feedback and considered it with ongoing feedback it received on the need for a combinations standard. Based on its deliberations, the Board decided to retain the effective date of January 1, 2022, to promote timely consistency in the reporting of NFPO combinations.

100 The AcSB also proposed that the standard be applied prospectively. The Board based its transition considering the following factors:

(a) No guidance currently exists in Part III of the Handbook and the scope out in Section 4450 directs stakeholders to other sources of GAAP.

(b) Combinations do not occur on a regular basis and some of the information on the combination might not be retained by the combined entity. Therefore, requiring an NFPO to go back and restate prior combinations can be very costly.

(c) Users of NFPO financial statements typically are concerned about combinations that are currently taking place and the impact on the NFPOs financial statements. Historical combinations are less of a concern and might not provide additional decision-useful information.

101 At the roundtable discussions during the exposure period, comments were raised recommending the AcSB allow NFPOs to restate previous combinations if the outcome differed from this standard. The Board considered this feedback and the advice of its Advisory Committee on this issue. Although the Board decided to retain the requirement to apply the standard prospectively, it revised the transition provisions to allow stakeholders to restate previous combinations to conform with this standard.

EXPOSURE FOR COMMENT

102 After resolving the issues arising during the exposure period, the AcSB considered, as part of its due process, whether the revisions to the proposals should be exposed for comment.

103 The revisions are highlighted in the relevant sections throughout the Basis for Conclusions. These revisions are clarifications based on feedback received from stakeholders. Other than clarifications already highlighted in the Basis for Conclusions, only minor drafting changes were made. Therefore, the AcSB decided that there was no need for re-exposure.
