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EXPOSURE DRAFT Proposed Statement of Financial Accounting Standards Business Combinations a replacement of FASB Statement No. 141

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## Comments

Question 1—Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

Yes: This is a major improvement over prior reporting standards and should greatly reduce the ability to manipulate earnings and financial ratios through "association" with entities by means other than equity investment.

Question 2—Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

Yes: This definition establishes the principal that achieving a return on investment through non-traditional channels does not permit the avoidance of consolidation. This is consistent with reporting the substance of a transaction rather than being bound by the form it assumes.

Question 3—In a business combination in which the acquirer holds less than 100 percent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognize 100 percent of the acquisition-date fair value of the acquiree, including 100 percent of the values of identifiable assets acquired, liabilities assumed, and goodwill, which would include the goodwill attributable to the noncontrolling interest? If not, what alternative do you propose and why?

Yes to accounting for the fair market value of identifiable assets and liabilities.

No to imputing goodwill to the non-controlling interest: The analysis beginning with A12 would be extremely compelling if we lived in a world where nearly all of those *responsible* for fair financial reporting were also *committed* to fair financial reporting. As today's (October 28) NY Times report on the SEC investigation into GM'S choice of interest rates to estimate its pension obligation shows, manipulation of financial reports remains commonplace. The proposal opens the door for numerous hard to audit and subjective decisions that will allow the non-controlling interest portion of goodwill to fluctuate widely. This proposal is an improvement over simply using implicit fair market value (Purchase price/Acquirer's %), but it leaves too many loopholes.

Question 4—Do paragraphs A8–A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

No: No amount of additional guidance would be satisfactory. A cancelled check, or the independently appraised value of identifiable assets and liabilities acquired, is as far as current valuation techniques can take us with any degree of reliability. We've all heard the joke about the accountant who is asked, "What is 2 +2?" It should not be given new life.

Question 5—Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

Yes: This is consistent with exchange based historical cost.

Question 6—Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

Yes

Question 7—Do you agree that the costs that the acquirer incurs in connection with a business combination are not assets and should be excluded from the measurement of the consideration transferred for the acquiree? If not, why?

No: The acquirer incurs these costs expecting them to be recouped from increased profits after the combination. This is conceptually identical to paying a control premium or a premium for expected synergies. Under current standards, if the new acquisition does not yield expected returns to the consolidated entity, then goodwill will be considered impaired in the near future. Acquisition costs are no different than shipping costs for a new computer, and both should be treated as part of the asset cost.

Question 10—Is it appropriate for the acquirer to recognize in income any gain or loss on previously acquired noncontrolling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

No: Using exchange price to value assets and liabilities survives because it is reliable. Without minimal reliability as an attribute of measurement discussion of relevance is pointless. The justification for using purchase price/acquirer's % as a starting point for valuing the acquiree is that the % is sufficient large (>50%) as to be a good first approximate of the acquiree's value as a whole. When a small increment in ownership results in control, the situation is likely to present opportunities for financial statement manipulation. For example, by purchasing 10% + 1 share, a 40% equity investment would yield control. Deliberate overpayment by the acquirer could then be used to justify recording gains for the prior 40% interest. A better solution would be to adjust identifiable assets and liabilities to fair market value, and record gains in comprehensive income. In particular, additional goodwill for the pre-existing interest should not be recognized.

Question 11—Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?

Yes

Question 12—Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

No: Management's judgment of value is the best measure for initial accounting. The FASB's initiatives in requiring regular impairment testing for assets, including goodwill is a major improvement in financial reporting. The best way of dealing with apparent over-payments in a non-fraud situation is to require management to explain in detail how cost recovery is expected to occur and to vigorously enforce subsequent write-downs when needed. Disclosing management's cost recovery models might be one way of ensuring that such models are not obviously unrealistic.