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Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Technical Director
File Reference No. 1204-001
Proposed Statement of Financial Accounting Standards: Business Combinations
(6/30/05)

I have the following suggestions concerning this exposure draft:

1. **Questions 4 –Measuring the Fair Value of the Acquiree (Paragraph 20--when the consideration transferred is not the best basis for measuring the acquisition-date fair value):**

Paragraph 20 has the right idea. I would take it a step further in light of the nonsensical reporting that often occurs when stock is issued as consideration. I use the AOL-Time Warner merger of 2001 to make my point. The consideration paid by AOL to acquire Time-Warner (hereafter TW) was roughly \$147 billion of stock, with roughly \$130 billion of that “cost” becoming goodwill. From a common-sense perspective, AOL’s shareholders never would have allowed \$147 billion of corporate cash (if AOL had accumulated that much cash) to be used to acquire TW. Secondly, AOL never would have been able to borrow \$147 billion cash from financial institutions for the purpose of acquiring TW. Thirdly, AOL never would have been able to issue new stock to the public for \$147 billion cash for the purpose of using that cash to acquire TW.

This economic reality suggests that **stock issuances** should be handled differently from when **cash** is the consideration. If this business combination had been a cash deal, the TW shareholders undoubtedly would have agreed to receive a drastically lower amount of consideration (probably closer to \$20-25 billion cash). **A requirement should exist for stock deals that the total cost cannot exceed what would have been paid out in a cash deal.** Undoubtedly, such a requirement would probably require obtaining advice from investment bankers. But the reporting results would be far more realistic than the ridiculously inflated amounts that occur under the present rules.

Recall that prior to the AOL-TW merger Verizon Communications walked away from AOL’s merger overtures toward Verizon because Verizon insisted on cash—not stock (funny money). Creating massive amounts of goodwill based on funny money values makes little sense.

Two other odd results occur as a result of subsequently writing down such massive goodwill amounts based on stock values. I continue with the AOL example. In 2002, AOL took a \$99 billion goodwill write-down (which resulted in the largest quarterly and annual losses ever reported by any company). First, this huge reported loss did not result in AOL filing for bankruptcy and going out of business, as investors might reasonably expect when a company reports such a staggering loss. Thus the \$99 billion loss was only a “paper loss”—not a true economic loss. Secondly, AOL is now saddled with a huge deficit balance in its Retained Earnings account such that it may be many decades before it can even think of paying a cash dividend (if ever), even if it were to begin having billion dollar net cash inflows from operations each year that could be used to pay cash dividends. (To put money into shareholders pockets, AOL, instead, would be forced into using stock buybacks.) The *form* is different, but the *substance* is the same.

2. Question 3—Imputing Goodwill for the Noncontrolling Interest (NCI):

I do not think it is appropriate to impute goodwill to an NCI. I think goodwill should be limited to the extent that goodwill was bought and paid for by the parent (as under the Parent Company Concept). I see no compelling need to impute goodwill—it merely adds complexity for no substantive benefit. Keep things as simple as possible—not as complex as possible.

3. Question 19—Style of This Exposure Draft.

I do find stating the principles in bold type helpful.

4. Page 41—the CU column:

Delete the rule under the 35.

5. Effective Date:

I would delay the proposed effective date one year to “on or after December 15, 2007.” Doing so would give corporate financial accountants a break from having to continuously deal with so many difficult issues (stock compensation, Sarbanes-Oxley).

6. General Comment Regarding Classifying Goodwill in the Balance Sheet:

Currently, goodwill is usually reported in the “**Other Assets**” category of the balance sheet. This categorical description does not indicate the true nature of goodwill (and of several other assets commonly reported in this asset category). In light of the staggering amounts that are reported for goodwill when common stock is the consideration given and in light of the staggering goodwill write-downs that have been made shortly after a business combination in recent years (the largest being AOL’s \$99 billion goodwill write-down in 2002—only one year after it acquired Time-Warner), the FASB should give serious consideration to mandating the use of a much more descriptive classification category for goodwill and certain other assets. The description “**Hollow and Dubious Assets**” comes to mind.

The distinguishing characteristics of items that would be reported in this category are that they (1) cannot be used to pay creditors, (2) cannot be used as collateral to borrow money against, (3) cannot be sold separately, (4) cannot be used in running the day-to-day operations of the business, and (5) are highly evaporable.

The more notable items that would be reportable in this category are (1) goodwill, (2) pension plan prior-service costs, (3) debt issuance costs, and (4) deferred stock option compensation costs. The use of this category would more clearly describe the true nature of these so called "assets" and readily enable investors to subtract these items in their totality from the total stockholders equity for the purpose of determining an entity's true stockholders' equity.

Very Truly Yours,

Arnold J. Pahler, Emeritus
Department of Accounting and Finance
College of Business
San Jose State University
San Jose, CA 95192-0066

Phone: (408) 924-3485
E-mail: pahler_a@cob.sjsu.edu

Author of: Advanced Accounting: Concepts and Practice, Thomson Learning/South-Western Publishing (currently in its 9th edition, published in March 2005)