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Letter of Comment No: 62

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Technical Director - File Reference 1204-001 Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Via E-mail: director@fasb.org

Re.: Business Combinations Exposure Draft

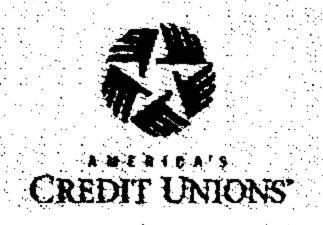
Dear Sir or Madam,

The Credit Union National Association (CUNA) is pleased to provide comments in response to the Financial Accounting Standards Board (FASB)'s Exposure Draft related to Business Combinations — a replacement of FASB Statement No. 141. Additionally, we appreciate the opportunity to participate in the Financial Accounting Standards Board's (FASB's) roundtable on October 27.

CUNA represents approximately 90% of the nation's nearly 8,900 state and federal credit unions that serve nearly 87 million members. This letter was drafted under the auspices of CUNA's Accounting Task Force, chaired by Scott Waite, SVP/CFO of Patelco Credit Union in San Francisco, as well as CUNA's CFO Council.

This is a very important accounting issue for CUNA's credit union members. Over the past five years (2000 – 2004), the total number of federally insured credit unions has declined by approximately 1,600 (over 15%). Approximately 85% of the decline was the result of merger transactions.

¹ Decline represents period of January 2000 thru December 2004. Based on data provided in the National Credit Union Administration 2004 Annual Report (pg 99).



The proposed Statement would make changes to the accounting rules that govern the combination of mutual entities. Specifically, it would eliminate the pooling method and replace it with the acquisition method. We remain convinced that the pooling method of merger accounting is the more accurate representation of the combination of credit unions because a merger represents the joining of the fields of membership of the credit unions (one credit union does not "acquire" another). Additionally, we believe the acquisition approach creates a burden that will inhibit the ability of credit unions to merge and add significant costs to such transactions. Moreover, this acquisition approach adds a degree of incomparability between those institutions that have merged from those that have not (there would be a difference in the equity section of the financial statements as well as the valuation allowances for the reasons mentioned later in this letter).

Use of the acquisition method would also:

- Require the determination of which credit union is the acquirer (buyer) and which one is the acquiree (seller);
- Require the acquirer to measure and recognize the fair (market) value of the assets and liabilities of the acquired entity at the acquisition date;
- Result in the potential recognition of a gain or loss at the acquisition date; and
- Result in ongoing costs associated with assessing any potential impairment of goodwill and intangible assets (annually at a minimum).

Summary of CUNA's Comments

- Because of the uniqueness of credit unions and users of their financial statements, we cite the following concerns with the Exposure Draft.
- We foresee several difficulties in fair valuing the credit union acquired in a merger.
 First, there is no observable market data on the fair valuation of an acquired credit
 union. In addition, there is no consistent valuation methodology. Further, we do not
 agree with the concept of determining a value of the entity as a whole. Again, there
 is no observable market data. And calculating this value would be a significant
 financial burden.
- We believe organizations should be allowed to continue carrying over the acquired entity's valuation allowance balance as it presents a useful financial picture for users of financial statements.
- We disagree with proposal's creation of a separate equity classification on the books
 of the acquiring institution for the amount equal to the fair value of the acquiree. The
 equity section of the balance sheet should be kept simple and clear for the benefit of
 the user of the financial statement.
- We do not support the change in the Exposure Draft providing that the costs the acquirer incurs in connection with a business combination, such as legal fees, should be expensed.

 We think it makes more sense to record the estimated cost amounts associated with restructuring or exit activities at the time the merger deal is completed as is done currently than to record such costs in the income statement when they occur as required under the Exposure Draft.

Discussion of CUNA's views

As mentioned above, CUNA believes that the pooling approach is the more appropriate approach to account for the merger of two credit unions. However, given that FASB is committed to requiring the use of the acquisition method approach to account for business combinations, we have comments on the Exposure Draft as discussed below.

Measuring Fair Value of the Acquiree

We have concerns that it would be difficult to obtain the fair value of an acquired credit union. Since credit unions are not purchased or sold, valuation methodologies utilized to determine the fair value of acquired credit unions could vary widely. The lack of a consistent market proven valuation methodology could result in numerous and possibly conflicting approaches. On the surface, it might appear that comparable businesses exist in the form of other types of financial institutions. Yet, differences in operational, market, financial and non-financial factors would make it difficult to arrive at a meaningful fair value.

Currently, two merging entities perform due diligence to determine if they should merge. While this would involve performing management level valuation analysis, it may or may not involve the utilization of a third party to perform a full valuation analysis. This due diligence process is not undertaken with the intention of determining a value of the entity as a whole, nor is it to determine the immediate equity, and/or income statement impact. Requiring a fair valuation will create a significant financial burden on the acquiring entity, and potentially impact the number of business combinations.

Overall, we disagree with the notion of valuing the entity as a whole because there is no observable market. Additionally, attempting to arrive at a value of the whole entity will create a significant financial burden on the acquiring entity, which under this proposal would all have to be absorbed at the time of acquisition.

While we have concerns about obtaining a fair valuation of the entirety of the acquired credit union, we agree the fair value of the assets and liabilities (including intangibles) should be obtained and goodwill for the net difference credited. We reiterate here our general opinion, however, that the fair valuation approach is not the optimal approach given the additional costs and resources required to obtain the fair valuation.

Treatment of Valuation Allowances

The proposal would no longer permit the acquiring credit union to carry over the acquired entity's valuation allowance. A valuable measure of performance within various industries is loss experience (loans or other types of receivables). The proposal would impact that comparability, and complicate the ability of evaluating the combined entity's performance.

Under the proposal, the credit risk associated with acquiring the receivables of the acquired institution would be reflected in the carrying value, primarily its loan portfolio. Consequently, any unrealized losses acquired in this portfolio would not be reflected in the allowance valuation. This could result in misleading financial presentation, since the change in fair value may not accurately reflect the loss experience. Changes in other valuation factors could mask loss experience that is better of worse than originally believed. For example, the fair value of a fixed rate loan portfolio would likely decline in a rising rate environment, even if the loss performance was better than had been anticipated.

While we understand the Board's desire to require that acquired assets and assumed liabilities be measured consistently, we believe carrying over the acquired entity's allowance balance would present a more useful financial picture for the end user.

Acquired Equity

Under the proposal, an additional component of equity would be created. We believe creating such an additional component clouds the balance sheet presentation. There has been concern expressed about the proposal's creation of a separate equity classification on the books of the acquiring institution for the amount equal to the fair value of the acquiree. There are already many different potential pieces for equity in general. We believe it is important that the equity section of the balance sheet remains readily understood. If the equity section of the balance sheet is kept simple, it is much clearer for the user of the financial statement.

Creating a new category/term of equity only for the purpose of the combination of two mutuals will not be readily understood and possibly misinterpreted as being restricted equity or somehow different than undivided earnings or retained earnings (which is a commonly understood term). However, there is no meaningful difference or restrictions and we believe the credit should be recorded as undivided earnings or retained earnings. A disclosure in the statement of members' equity could be provided, indicating to portion arising from acquisition.

Costs Incurred in Connection with a Business Combination

The Exposure Draft indicates that the costs that the acquirer incurs in connection with a business combination -- for example valuation costs, legal fees and accounting fees -- should be expensed, since they are not part of the cost of the acquiree. While the proposal focuses on the services provided for the fees incurred, it completely discounts the reason these costs were incurred.

The board has indicated that it does not believe a seller would be willing to accept less than fair value for its business because of the acquisition related costs a buyer would incur. It is true that the acquisition costs of two or more prospective buyers would not be the same, but this argument should not be completely dismissed. If the range of acquisition costs were 3% - 5% of the sale price, is it reasonable to believe that none of the prospective buyers would be willing to pay the full amount. As opposed to not selling the business, a seller may decide to accept a price less than fair value due to these cost considerations.

Every day, in real estate transactions a similar event occurs on the buyer side. A sale price of a piece of property includes reimbursement of commission costs. Commission costs are a cost of the transaction that the seller factors into what they are willing to accept for their property. Through market valuations that utilize comparative sales data, these costs become built into the fair value. Consequently, a market approach to valuing property typically includes acquisition costs. Subsequently, a buyer is willing to pay more for a piece of property due to the sellers cost related to disposing of the property.

The acquisition of an entity is viewed as a long-term value for the combined organization. We do not believe the expensing of such costs as incurred is consistent with the period the resulting value will be recognized. CUNA thinks credit unions and other institutions should be allowed to continue to capitalize acquisition costs and amortize them over an appropriate period.

Liabilities Associated with Restructuring or Exit Activities

Currently, in a merger, the surviving credit union typically estimates cost savings – layoffs, severance packages, closing overlapping branches – and sets up costs as liabilities that increase goodwill. When the expenses actually occur, there is a balance sheet adjustment as of the merger date. However, under the acquisition method, credit unions must record such costs in the income statement when they occur. Generally, such matters arise only because two organizations choose to merge.

We believe the current accounting method is adequate and suggest that increased disclosures be considered in lieu of changing the accounting treatment. (Here we would add that in our opinion the minimum disclosure requirements in the Exposure Draft are reasonable.) We think it makes more sense to record the estimated cost amounts at the time the merger deal is completed, clean up the balance sheet and move forward.

We appreciate the opportunity to participate in the roundtable. If you have any questions, please contact me by phone at (202) 508-6743 or by e-mail at corr@cuna.com.

Sincerely,

Catherine Orr

Senior Regulatory Counsel

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Credit Union National Association