



Air Products and Chemicals Inc.
7201 Hamilton Boulevard
Allentown, PA 18195-1501
Tel (610) 481-7932
Fax (610) 481-7009
e-mail: huckpe@airproducts.com

Paul E. Huck
Vice President and
Chief Financial Officer

28 October 2005

Letter of Comment No: 58
File Reference: 1204-001

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

Dear Sir or Madam:

We appreciate the opportunity to comment on the Proposed Statement of Financial Accounting Standards on Business Combinations dated 30 June 2005. Air Products is a major supplier of industrial gases and related equipment, chemicals, and environmental and energy systems with consolidated annual sales over \$8 billion.

The proposed rules will add a significant degree of complexity to the financial statements as well as additional disclosures at a time when filing deadlines are being shortened. Fair value accounting is being selected over the historical cost model resulting in financial statements that are a mixture of both historical costs and fair values. The financial statements will be harder to understand and use and there will be greater income statement volatility following a business combination. Additional disclosures will be required to compensate for the proposed accounting. We also believe that this statement opens up the possibility for a number of potential abuses by financially engineering the transaction to exploit the rules and produce accounting results that are not reflective of the transaction or economic reality. We support the continued use of the present GAAP model, with certain changes for acquisition costs and liabilities, as we believe it fairly presents a business combination in the financial statements.

Comments on Issues for Respondents

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

We agree with the Board's position that the fair value of contingent consideration should be recognized at the acquisition date. However, we disagree with the accounting for contingent consideration after the acquisition date. Contingent consideration is the risk sharing that the buyer and seller absorb for the future performance of the business being bought or sold. That future performance provides a better indication of the fair value of the business that existed on the acquisition date and enables the buyer and seller to adjust the consideration transferred in the transaction. Any adjustments to the contingent consideration should be reflected in purchase accounting as this will more accurately reflect the substance of the transaction. Contingent consideration agreements are entered into because of significant differences in opinion between buyers and sellers concerning the fair value of a business.

An additional problem with this requirement is the impetus it provides companies to manipulate the initial purchase accounting. If a company doesn't provide an adequate accrual, it is penalized in the future through a loss in earnings. If the company's accrual is in excess of the final obligation, it records a gain in earnings. We are very concerned that the rules established in this area are designed in a way that they could be abused in transactions structured to achieve particular objectives. For example, an acquirer who was interested in keeping its asset base low could engineer a transaction that had a significant portion of the consideration under a contingent arrangement. The buyer could value that contingent arrangement conservatively. When it pays out in the future at a greater value, the entity would take a "one-time charge" for the arrangement's excess above the original valuation. Investors and analysts usually ignore these types of adjustments. The result is that the returns on assets and capital would be artificially inflated by undervaluing the assets acquired initially and not adjusting for the final consideration. A self-serving acquirer could portray this acquisition as a success due to the under-valued asset base as the one-time charge would be ignored.

A similar abuse could exist for the write-off of in-process R&D. By proper structuring, an acquirer could undervalue its goodwill if the objective was to increase its return on assets or return on capital employed. Conversely, if an acquirer wants to produce "earnings" from the acquisition, it could stage a series of payouts over the first few years that they would fall short of and, therefore, produce gains each year as the milestones were not met. While that company would overstate its assets initially, if it could absorb the drop in returns with its investor base, it could produce earnings which would not be real. For these reasons, we strongly urge the Board to have all of the payments for contingent consideration be included in the purchase price.

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?

We agree with the proposed treatment of costs incurred by the acquirer. The costs are for services rendered and benefits received prior to the acquisition and do not represent assets with future economic benefit to the company. Additionally, the accounting for internal and external costs incurred would be consistent.

Question 8: Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose.

We agree with the proposed changes related to this question. In particular, we favor the proposed changes related to restructuring and exit activities as the current rules do not provide for consistent treatment of restructuring plans for company-owned facilities/employees with plans for acquired facilities/employees.

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?

We do not agree with recognition of a gain or loss for a step acquisition. A purchase transaction is not the culmination of an earnings process and should not result in a gain or loss in earnings. Most readers would interpret the gains or losses as one

time events and simply omit them from the earnings of the company. However, in future periods the gain or loss on the previously acquired interest will be amortized into earnings and that won't be easily identified by readers. Costs will be recognized in the income statement that never represented a cash outlay.

The Board defends this decision by drawing an analogy to the accounting treatment for financial instruments; however there are inconsistencies. Financial instruments are revalued at each reporting date whereas the noncontrolling interest in the subsidiary would only be revalued on the acquisition date. If the situation arose where the acquirer later obtained additional interest in the entity, there would not be a similar adjustment to fair value. Additionally, gains and losses on financial instruments are not always treated in the same fashion. In some cases, the changes in fair value are recorded to earnings, but in other instances such as securities held for sale, gains and losses are recognized through comprehensive income.

Another problem with the proposed standard is that the potential exists for business combinations to be structured in such a way that would manipulate the rules. As an example, a company could own 50 percent of a non-consolidated entity and record the investment on its books under the equity method. If the per share fair value of the entity was more than the per share value carried on the books, the company could record a significant gain in earnings by simply buying 0.1 percent more ownership and taking control. That transaction (meets the definition of a business combination) would trigger consolidation and allow the acquiring company to write-up the 50 percent it held previously to the current fair value with the offset to earnings as a gain (although it would need to be disclosed).

Based on the points above, we believe that the historical cost approach currently in effect is appropriate for step acquisitions.

Conclusion

We believe that the Board should establish the principle that measuring acquisitions at the actual consideration paid is the best method and that regardless of whether the acquisition is done in steps or has contingent considerations paid in the end, the users of financial statements are best served if the value of the acquisition is measured by the value of cash and securities delivered on the day they are paid. This will prevent abuses and financially engineered transactions that are designed to produce certain accounting results or objectives of an acquirer. It will also keep the consistency across the transactions that would allow better comparison of companies by investors and users.

We thank you again for the opportunity to express our views on this important issue and would welcome any further inquiry by the Board to ensure our position is fully understood.

Sincerely,



Paul E. Huck