

28 October 2005

Letter of Comment No: 80
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Our ref FASB/SMH/CC

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Dear Ms Bielstein

Reference No. 1204-001 – Proposed Statement of Financial Accounting Standards – Business Combinations a replacement of FASB Statement No. 141

Fidelity International Limited appreciates the opportunity to comment on the FASB's exposure draft (ED) 'Business Combinations'.

By way of background, Fidelity International Limited ("FIL") is a privately owned asset manager which provides investment advisory, management, and investor services for a range of collective investment schemes and separately managed accounts for individual and institutional customers including pension plans. The Group also develops markets and sells/licenses mutual fund-related application software and invests in emerging businesses. The Group's head office is in Bermuda. The Group also operates in many other countries across the world, principally in Europe and Asia. FIL, which reports to its shareholders and other financial statement users under Accounting Principles Generally Accepted in the United States of America, is a separate company from Fidelity Investments in the United States.

We support the principles in this ED but have concerns at some of the specific measures proposed. Our principal concerns relate to the expensing of transaction costs, the full goodwill method and the goodwill remeasurement time period,

Transaction Costs

We believe that transaction costs form part of the consideration and should be an increment to goodwill. We believe that expensing them is inappropriate from a theoretical, practical and commercial perspective and is inconsistent with treatment applied for the acquisition of other assets. In our assessment of an acquisition and the related return to our shareholders, we consider the total economic costs to our organisation in the completion of the acquisition. It is our belief that this total cost should be reflected as part of acquisition costs and not as a period cost.

Full goodwill method

We believe that whilst there is a theoretical attraction to applying the same idea to goodwill as to other assets it would be impractical to implement. This is due to the impact of control premiums on reliable measurement of the entity value and the difficulty of allocating subsequent impairments between controlling and non-controlling interests.

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Goodwill remeasurement time period

We would prefer that the cutoff is the end of the second accounting year after acquisition.

Our comments on this and other specific response questions are set out in the appendix to this letter.

We appreciate the opportunity to express our views. If you have any questions regarding our comments or would like to discuss any in more detail, please contact me on 11 44 1732 777436.

Yours sincerely



S.M. HASLAM
Chief Administrative Officer

Appendix – Fidelity International Limited's responses to the specific questions raised in the ED's Notice for Recipients

Question 1—Objective, Definition, and Scope

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.

Question 2—Definition of a Business

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.

Questions 3–7—Measuring the Fair Value of the Acquiree

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?

No.

We believe that whilst there is a theoretical attraction to applying the same idea to goodwill as to other assets it would be difficult to apply in practice as:

- Assessing the fair value of a 100% holding based on a prorating of the price paid for the controlling interest is misleading as there would be a control premium within the price paid which in practice would be impossible to measure reliably. Therefore the fair value is likely to be overstated.
- Serious practical implementation issues would arise in the event of a subsequent impairment – it may be impossible to identify that part of the impairment attributable to the noncontrolling interests under some circumstances, for example if the goodwill had become indistinguishable from a greater pool of goodwill following internal reorganisations of the acquiring entity.

We propose the existing treatment for majority acquisitions and subsequent transactions.

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

We have no comment on this item.

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, subject to our comment on question 7.

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

Yes, this is appropriate. We would however prefer the time period for revision to the goodwill to run to the end of the second accounting year after acquisition rather than to one year after. This would be more aligned with the business realities of the use of contingent consideration and the implications of events which existed prior to the transaction and which were a matter of disagreement between buyer and seller to crystallise; thus providing preparers of financial statements between one and two years to remeasure goodwill (while such contingent amounts would be disclosed in the financial statements).

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, we do not agree. We believe they are part of the consideration and are therefore goodwill. Our reasoning is as follows:

- Transaction costs are part of the cost of bringing the company to a position where it gives an economic return to the purchaser and its shareholders (and such amounts are not a period cost). An appropriate analogy is with fixed assets where transportation and installation costs would be capitalised as well as the 'fair value' paid to the vendor (the additional costs have future economic value and therefore recognised not in the current period but rather in the period of use).
- From a theoretical perspective in a perfect market a rational purchaser would start with the present value of prospective cashflows from the post-transaction acquired business and deduct transaction costs to arrive at the maximum price to pay to the vendor. Therefore the transaction costs (and committed restructuring costs) plus the price paid should be a reliable estimate of the fair value to the purchaser of the acquired business.
- The transaction costs were incurred as part of the costs of acquiring a future cash inflow. Simple accrual accounting requires that these costs be matched with those inflows (if there are inadequate inflows the goodwill impairment requirements will address that issue).
- The proposed requirement to disclose expensed transaction costs implicitly acknowledges that users will wish to identify an income figure excluding transaction costs. This suggests that expensing does not meet user requirements, and rather would be eliminated by users in determination of current year results.
- Immediate expensing ignores the commercial side of the acquisition decision – the decision to acquire, and the price to pay, would relate to all costs incurred – the consideration reported would effectively make acquisitions look cheaper than they were assessed to be by management.

Questions 8 and 9—Measuring and Recognizing the Assets Acquired and the Liabilities Assumed

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?

No. We believe that valuation of contingencies should be consistent with the methodology applied to contingencies arising during the normal course of business.

Whilst there is a theoretical attraction to recognising the expected value of remote contingencies there are serious issues of reliability in the making of such valuation and probability estimates. It is unsatisfactory that two otherwise identical companies would treat contingencies differently just because one was an internally generated contingency and the other was an acquired contingency.

Question 9—Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

We believe the proposed exceptions are appropriate.

Questions 10–12—Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations

Question 10—Is it appropriate for the acquirer to recognise 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 would prefer that the gain be recognised in other comprehensive income until there is an external transaction.

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.

Question 13—Measurement Period

Question 13—Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

We do not agree. Remeasurement is essentially a revision of an estimate and we believe that this type of adjustment should be made prospectively for consistency with how any other estimate is treated.

Question 14—Assessing What Is Part of the Exchange for the Acquiree

Question 14—Do you believe that the guidance provided is sufficient for making the

assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

We do not agree with the premise that these items are not part of the exchange.

Question 15—Disclosures

Question 15—Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

We have no comment on this item.

Questions 16–18—The IASB's and the FASB's Convergence Decisions

Question 16—Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognized separately from goodwill? If not, why? Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristics:

- a. The intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or liability*
- b. Cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?*

We have no comment on this item.

Question 17—Do you agree that any changes in acquirer's deferred tax benefits that become recognizable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

We have no comment on this item.

Question 18—Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

We continue to believe directionally the convergence to a global set of accounting standards is best for the global economy. As such, whilst we believe the differences should be resolved in the drafting process we have no comment on this particular item.

Question 19—Style of This Exposure Draft

Question 19—Do you find stating the principles in bold type helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

We do find it helpful.