

R.G. Associates, Inc.
Investment Research/ Investment Management
201 N. Charles Street, Suite 806
Baltimore, MD 21201

Jack T. Ciesielski, CPA, CFA
President

Phone: (410)783-0672
Fax: (410)783-0687

File Reference 1204-001

October 26, 2005

Letter of Comment No: 24
File Reference: 1204-001
Date Received: 10.26.05

Ms. Susan Bielstein
Director, Major Projects & Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Ms. Bielstein,

I appreciate the opportunity to comment on the exposure draft of the proposed standard "Business Combinations, a Replacement of FASB Statement No. 141." In general, I agree with the changes to the business combination accounting model proposed in this document; I believe that the differences it would bring to financial reporting of business combinations would be significant improvements, and the changes would not be excessively costly for firms to implement.

* * * * *

Questions 1 & 2 —Are the objective and the definition of a business combination appropriate for accounting for all business combinations?

I believe the objectives and definition of a business combination are appropriate and well-defined. The scope is broad and appropriate; I believe that the standard should take in business combinations of enterprises other than for-profit institutions without exception, as well as the different variations of business combinations. The definitions are sufficiently described for a principles-based standard.

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?

I agree with the treatment proposed for this kind of business combination. The main drawback is that this treatment will force acquirers to confront the nebulous issue of control. Recognizing all of a company's assets and liabilities will not be desired by companies having less than full ownership of another, and I suspect that this method of accounting will drive many firms to demonstrate why they don't have enough control to justify full consolidation when they only own a portion of a company.

The proposed standard might set off a game of accounting "Whack-A-Mole:" while it might smack down the inferior mixed-basis reporting of the value of companies acquired through step acquisitions, it would likely make control issues pop up.

That's not an entirely bad thing: the control issues need addressing anyway, so the value issue of less-than-100-percent acquisitions should be addressed as proposed. In conjunction with the Board's concurrent proposal for reporting of non-controlling interests, this proposal is an improvement over existing practice.

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

I believe the guidance for measuring fair value of an acquiree is sufficient as described.

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?

The fair value of consideration transferred for an acquirer's interest is the best measure of the interest's fair value, and it should not be measured later than the acquisition date. To measure the fair value of the acquisition later implies that the buyer didn't really have an idea of what was likely to be given up. Put differently, a buyer might want to wait to see if certain events occur - profitability levels, or retention of customers and employees, for example. At the time of the acquisition, however, it's likely the buyer has a pretty good idea of how things will turn out and what will have to be paid - or at least, *should* have a pretty good idea. Because there's no requirement record in dollar values what's expected to be paid, buyers might not quantitatively articulate what they expect to pay. This standard would force them to do so, and I believe they're capable of doing so.

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

I believe the accounting for contingent consideration after acquisition date is appropriate as described for the reasons given in the answer to Question 5.

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?

I agree that the transaction costs of an acquirer are not assets and should be excluded from measurement of an acquisition. This has been one of the more contentious parts of this proposal, with plenty of analogies to inventory accounting and property accounting: the cost of say, freight, is capitalized as part of the cost of inventory, or putting new machinery into place. Another analogy: the cost of broker commissions are added to the cost of stocks held in a portfolio.

Those analogies are certainly accurate, but they're also incorrect. Transaction costs like freight or broker commissions are not assets in and of themselves: they're the admission fee paid at the gate to obtain control of the real assets. They have no utility to the acquirer of inventory, machinery or stocks beyond allowing the transaction to take place. (Perhaps the accounting for them should be re-examined.) Likewise, the transaction fees for investment bankers, lawyers, and accountants in an acquisition do not generate returns for the acquirer in the years after the acquisition; the acquired assets produce the returns. Bankers' fees are the toll paid on the road to acquiring the assets that should be recorded at fair value.

(If companies could get past the shock of reporting what they pay for such services, they'd realize that the immediate expensing of such items buys them a layer of protection in their goodwill testing: all else equal, this would record lower goodwill in a purchase acquisition than the current accounting.)

Question 8—Do you believe that these proposed changes to the accounting (for accounts receivable, contingent obligations, restructuring/exit activities, and in-process R&D) in business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

I believe that the proposed changes in the accounting are appropriate, manageable by acquirers, and in the case of the accounting for exit costs, long overdue.

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

The exceptions to the fair value measurement principle are appropriate.

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?

I think the accounting for changes in control can work as outlined in the Exposure Draft. My main concern is that it might lead to gaming of the “control” aspect by firms for the purpose of generating “at-will” gains. I realize that the gains/losses are required to be disclosed in the GAAP financial statements. (Although this is not a flaw in the Exposure Draft, it’s their discussion/disclosure outside of the GAAP financial statements that concerns me.)

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?

I agree with the accounting for “bargain purchase” business combinations and I would not care to see the accounting for “overpaid” business combinations treated symmetrically.

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?

I don’t believe that there are circumstances in which overpayment could be reliably measured at the acquisition date.

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?

I believe the adjustment of comparative information in prior periods presented for the subsequent measurement adjustments would enhance the comparability of the financial statements.

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?

I believe the guidance in the Exposure Draft is sufficient.

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?

I agree with the disclosure objectives and minimum disclosure requirements in the Exposure Draft.

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?

I believe that an identifiable intangible asset can always be measured with sufficient reliability but it depends on what you mean by “sufficient.” If an intangible can be identified, and cash flows projected for it, I can’t see why appraisers or buyers can’t apply standard financial theory like discounted cash flows to value the intangible. It comes down to the question of what is meant by “sufficient:” as long as it doesn’t mean “absolute,” I believe that identifiable intangibles can be valued separately from goodwill.

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?

I agree with the proposed change: if the changes in the deferred tax benefits are not attributable to the business combination, then it is more appropriate to account for them outside of adjusting goodwill, most likely in post-combination income from continuing operations.

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?

I believe that the disclosure differences work for the two different sets of constituents and there is no need to eliminate them at this time.

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?

I found the style to be satisfactory and not really a big adaptation to make.

Those are my only comments. If you have any questions, please do not hesitate to call me. Best regards.

Sincerely,

Jack Ciesielski
jciesielski@accountingobserver.com