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Paul S. Efron
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September 23, 2005

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: FASB Exposure Draft, Proposed Statement of Financial Accounting Standards, "Business Combinations, a replacement of FASB Statement No. 141"

Dear Mr. Herz:

Goldman Sachs appreciates the opportunity to comment on the Exposure Draft referenced above ("the proposal"). We further appreciate the Board's willingness to host roundtable discussions with constituents, and respectfully request the opportunity to participate in the October 27, 2005 discussion.

Goldman Sachs supports the Board's effort to improve financial reporting while promoting the international convergence of accounting standards. However, we have broad conceptual and practical concerns with the proposal and are not supportive of its issuance in its current form. We have three overarching comments.

First, while we have been and continue to be strong advocates of fair value accounting for financial instruments, we believe applying a fair value model to nonfinancial instruments that cannot be supported by substantive evidence, raises serious reliability issues. We are concerned about the prospect of applying fair value in areas such as litigation and contingent consideration where only hypothetical reference markets exist, and believe that initial measurement errors and subsequent changes in fair value will be, as a practical matter, inseparable. Put simply, fair value estimates in these areas will be, in many cases, wholly unreliable.

Second, we disagree with the presumption in the proposal that the fair value measurement of the business acquired should only reflect the consideration received by the seller, and ignore other amounts paid by the buyer in contemplation of the acquisition.

The more reasonable presumption in such transactions is that both parties are acting rationally. The other amounts paid by the buyer (e.g., restructuring costs and professional fees) are part of the buyer's total purchase price. The buyer uses that total purchase price to forecast the transaction's internal rate of return (IRR), impact on earnings, and other performance metrics. In short, if the economic analysis prepared by the buyer incorporates all cash flows, including amounts paid to the seller, then so too should the accounting model, provided these additional amounts are clearly related to the transaction.

Third, we are concerned that the proposal will introduce ongoing income statement adjustments to the buyer's financial statements that will be unrelated to the current operating performance of the combined entity. Inevitably, and understandably, acquisitive companies will need to resort to pro forma, non-GAAP measures in an effort to explain their current operating results to users of their financial statements. That would be a troubling and all too familiar development, in our view.

More detailed topical discussions follow below, including our specific recommendations for dealing with these aforementioned concerns.

Contingencies and Contingent Consideration

We believe the risk of measurement error in accounting for contingencies and contingent consideration at fair value will be high and, in our view, unacceptable. We agree with the alternative view expressed in paragraphs B206 through B208 of the proposal, particularly that the fair value measures will be "artificial constructs that lack representational faithfulness with actual economic phenomena."

In its proposal, the Board expressed concern over measurement error in relation to nonfinancial instruments where estimates are not based on actual or potential exchange transactions or market inputs. In our view, it is generally impractical to ascribe an initial fair value to nonfinancial instruments when no reference market or other substantive evidence exists.

As a general principle, many contingencies are outside the control of the acquirer and may or may not come to pass. In the absence of observable market measures or inputs, we believe it would be extremely difficult, if not impossible to determine whether the adjustment resulted from a change in the facts and circumstances of the acquiree, warranting an adjustment to the purchase price, or if the change resulted from measurement error.

We encourage the Board to adopt an approach similar to that taken in its Fair Value Measurements/Day 1 Difference projects to require a minimum reliability threshold for the measurement and remeasurement of contingencies and contingent consideration. We believe the Board should require initial and subsequent measurement at fair value only if the initial measurement is a level four measurement or better. In other words, if the initial estimate is a level five measurement, current practice should be retained.

If the Board believes current practice should not be retained, one alternative would be for the Board to lower the threshold for initial and subsequent recognition of contingencies from the "probable" threshold found in FASB Statement No. 5, "Accounting for Contingencies", to a "more likely than not" (i.e., > 50%) threshold. Such an approach would recognize that parties often negotiate meaningful contingencies that are less than probable, and therefore not recognized under current practice. If the Board adopted this approach, however, it would eventually have to reconcile the "probable" threshold for contingencies recognized in the ordinary course of business with the "more likely than not" threshold for contingencies recognized in a business combination.

Restructuring Costs

We do not agree with the presumption in the proposal that the fair value of the acquired business should only reflect the consideration received by the seller. In our experience, restructuring costs which are contemplated by the buyer at the time of acquisition are considered part of the total purchase price of the acquiree. They are necessary to achieve the contemplated synergies from completing the combination. Transactions in which a buyer can achieve synergies through restructuring will have a significant positive impact on both the price the buyer is willing to pay the seller, and the in-use value of the restructured business. The additional value resulting from such synergies is a determinant in the buyer's decision to engage in the purchase and related restructuring and, as noted, is used to forecast the transaction's impact on earnings, IRR, and other business performance metrics.

If such restructuring items are identified at the time of acquisition, and management has committed to a plan to restructure, we believe provisions should be established for such costs and included as part of the purchase price. Any unutilized provisions should be credited against goodwill.

Acquisition-Related Costs

We believe acquisition-related costs are part of the buyer's total purchase price of the acquiree. They are an inextricable component and essential requirement of business acquisitions. Expensing these items at the outset would inappropriately reduce current period earnings because the economic impact of the associated transaction would continue over time.[1] We believe the proposed accounting would diverge from the economic reality of these transactions.

We also believe the proposal allows the accounting treatment for certain assets to be determined by the method in which an asset is acquired, thereby resulting in inconsistent approaches for similar assets. One example is with a purchase of a building. Current GAAP would require capitalizing acquisition-related costs associated with the purchase of a single

[1] We are concerned the Board's decision to expense acquisition-related costs in current period earnings will become more problematic if the Board moves forward with its Liabilities and Equity project and also require the expensing of issuance costs in current period earnings (frequently incurred in connection with an acquisition). We believe costs incurred to issue debt and equity instruments benefit the issuer during the period the instruments remain outstanding. Therefore, we believe current practice in this area also should be retained, that is, amortize debt issuance costs over the life of the debt, and charge equity issuance costs against paid-in capital.

building, while the proposal would expense those costs if the building were acquired in a business combination. We caution that such differences would imply that the accounting treatment for acquired assets should be determined by the method in which the asset was acquired. Acquisition-related costs, whether incurred in a single asset purchase or a business combination, are costs fundamental to the acquisition and, under both circumstances, should be capitalized. We also believe the requirement to periodically test goodwill for impairment on a fair value basis mitigates concerns some may have about including acquisition-related costs as part of the purchase price.

Finally, we also believe there is a potential for inconsistent treatment between the seller's and buyer's transaction costs when the seller's costs are paid by the acquirer. For example, in the case of acquisitions of public companies, the seller's costs are generally assumed liabilities that reduce the net assets of the target company. In short, the proposal would permit the seller's costs of a business combination to be capitalized, yet require expensing of costs paid by the buyer. As noted, the determination of the purchase price involves many factors that are difficult to value and often involve assets and liabilities where no reference market or other substantive evidence exists. As such, we believe the seller's transaction costs are embedded in the purchase price of the acquisition, and become part of, and inseparable from, goodwill.

Step Acquisitions

We believe fair value is the right approach for acquisitions of additional interests in step acquisitions. Having said that, full remeasurement of an acquiree in a business combination achieved in stages is certain to increase the recognition of gains and losses by the acquirer on its previously-owned interests. We believe that if profit or loss cannot be observed using a level four measurement or better, then the credit should be recorded as a deferred credit and recognized if and when it becomes a level four measurement or better.

Acquisition Date

We believe the risks and rewards of an acquisition are transferred on trade date – the date parties enter into acquisition agreements. Therefore, the acquisition date for business combinations should be that date. In contrast, the proposal effectively adopts a settlement date approach for business acquisitions, as the acquirer typically obtains control on the date the assets are transferred and consideration is exchanged.

If an acquirer has made a commitment to purchase, conditions that change post trade date are usually outside the control of the acquirer and are not indicative of the exchange agreed to between parties. There are often legal ramifications if the parties involved in the acquisition withdraw from the transaction prior to an acquirer taking possession of the acquired entity, and penalties for nonperformance agreed to in the purchase contract may be sufficient to make the possibility of withdrawing from the transaction remote. Using the date of transfer as the acquisition date could cause changes in stock market prices to inappropriately generate negative goodwill (i.e., gains in income) or create inflated goodwill, triggering impairments that otherwise would have been avoided.

Measurement Period
Our experience is that buyers frequently obtain new information about the assets acquired and liabilities assumed throughout the measurement period, and thus make provisional fair value estimates on the basis of the best information available. Nevertheless, information can and often does change during the measurement period, and to require restatement for each change strikes us as impractical. Therefore, we believe adjustments made to provisional values that are recorded within one year of the closing date should be accounted for prospectively. Moreover, we are concerned the restatements required by the proposal could expose public companies to increased business risk resulting from litigation and Sarbanes-Oxley certification requirements.

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Thank you for the opportunity to present our views. Please contact Matthew Schroeder or me if you want to discuss this letter in more detail.

Sincerely,

/s/ Paul Efron
Paul S. Efron

cc: Matthew Schroeder