Letter of Comment No: 208 File Reference: 1204-001

November 7, 2005

Ms. Stephanie Tamulis
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 1204-001

Dear Ms. Tamulis:

The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to comment on the FASB's June 30, 2005 Exposure Drafts of the proposed Statements of Financial Accounting Standards, Business Combinations: a replacement of FASB Statement No. 141 and Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries – a replacement of ARB No. 51.

Overall, the majority of AcSEC members are not supportive of the proposal to measure the acquiree, as a whole at fair value, due to the consequences of such a decision. These concerns are described in our answers to the questions in the EDs. Further, a majority of AcSEC members do not agree with the proposed changes in the consolidation model. AcSEC is supportive of the FASB's overall direction to improve the relevance of financial information by utilizing fair value measurements to the extent practicable. In that regard, however, there are several areas where we question the ability of preparers to reliably estimate fair value and the relevance of such estimates.

We would also note that a significant minority of AcSEC were supportive of the proposed model to measure the acquiree, as a whole, at fair value and were also supportive of the proposed consolidation model.

A more complete response to the Board's specific questions as well as additional comments on the Exposure Drafts are included in the attached. Our responses have been drafted based on the majority view described above. We have not included the minority view on the individual questions. Representatives of AcSEC are available to discuss our comments with the Board members and staff.

Sincerely,

Ben Neuhausen, Chair Accounting Standards Executive Committee Jan Hauser, Chair Business Combinations

Task Force

Appendix A

RESPONSES TO SPECIFIC ISSUES:

Proposed FASB, Business Combinations: a replacement of FASB Statement No. 141

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?

AcSEC is supportive of the FASB's overall direction to improve the relevance of financial information by utilizing fair value measurements to the extent practicable. However, AcSEC is not supportive of the proposed objective of the ED that requires measuring the acquiree, as a whole, at fair value. While the concept of full fair value sounds appealing, AcSEC does not support the proposal due to the consequences of such a decision.

In that regard, AcSEC does not believe that a holding gain or loss should be recognized by an acquirer on its pre-existing interest when the acquirer increases its ownership interest to the level of control. AcSEC does not believe that a gain or loss is inherent in such a transaction. Further, AcSEC believes that the parent's equity interest is fundamentally different than the interest of a noncontrolling shareholder and, therefore, also does not agree with the subsequent accounting consequences that results from the proposed model. AcSEC does not believe that the purchase of an additional interest in a consolidated subsidiary is an equity transaction; AcSEC believes this is a purchase transaction that should be reflected as part of the parent's investment in the subsidiary. Likewise, AcSEC does not believe that the sale of a portion of a parent's interest in a subsidiary with independent third parties is an equity transaction; it is an exchange transaction for which a gain or loss should be recognized.

AcSEC does acknowledge that the consequence of this view results in a mixed basis for an acquired business when acquired in steps. However, AcSEC believes that this consequence is representationally faithful to the investment decisions made by the parent.

AcSEC is particularly concerned with the proposed concept that a holding gain or loss should be recognized by an acquirer on its pre-existing interest when the acquirer increases its ownership interest to the level of control in a transaction where control is obtained through means other than an acquisition of net assets or equity interests (such as a transaction where control is achieved by contract alone or the modification of

shareholder rights). This particular concern arises because no consideration changes hands to provide objective evidence of fair value at the transaction date.

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?

AcSEC is generally supportive of the proposed expanded definition of a business, but believes that the final guidance should include examples that illustrate what types of activities and assets acquired and liabilities assumed would be considered a business under the Statement and, likewise, what types of transactions would be considered an acquisition of net assets (and not a business). AcSEC believes the examples in EITF Issue No. 98-3, Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business, have been helpful in providing additional guidance. Thus, AcSEC recommends retaining the guidance in these examples and consider whether additional examples would be helpful. In this regard, some of the existing examples will clearly illustrate that the acquisition does involve a business due to the expanded definition of a business. AcSEC recommends that additional examples or guidance be provided for situations in which the acquisition includes a singular income-producing asset (for example, an investment property) and whether such an asset should be considered a business.

However, AcSEC does not agree with the proposed guidance in paragraph A7 of the ED that the existence of goodwill, in the absence of evidence to the contrary, leads to the presumption that a particular set of assets and activities is a business. AcSEC believes that the concept of a business is appropriately articulated in the ED, and that the valuation of a particular group of assets should not drive a conclusion in this regard. AcSEC does not believe that the existence of a residual after the valuation of a group of assets should result in a conclusion on whether a business has been acquired. AcSEC recommends that the existence of goodwill could be considered as a possible indicator that a particular set of assets and activities are a business, rather than a presumption.

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?

AcSEC opposes the recognition of 100 percent of the fair value when such accounting gives rise to holding gains or losses on pre-existing ownership interests. AcSEC does not believe that an exchange has taken place relative to its pre-existing interest and, therefore, a gain or loss should not be recognized merely as a result of increasing the ownership interest to the level of control.

AcSEC believes that a parent should reflect its ownership interests on the basis of its cost to acquire that ownership interest and that the performance of the investment should be based on historical invested capital. That is, return on investment, impairment, and gains and losses on the sale of such investment should be based on historical invested capital.

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

AcSEC agrees that the fair value of the consideration transferred by the acquirer on the acquisition date is the best evidence of fair value of the acquirer's interest in the acquiree.

AcSEC does not agree with the proposed model in the ED, but if the FASB continues with the proposal to measure the acquiree as a whole at fair value, we have the following concerns.

AcSEC believes additional guidance or further illustrations regarding control premiums would be helpful. To illustrate, this guidance would be helpful when considering how one should evaluate a step acquisition in which the ownership interest increases from 40% to 51%. In that situation, the cost of the additional 11% is assumed to be the fair value of the interest acquired, yet it may have been purchased at a premium in order to obtain control. It is often difficult to ascertain whether or how much a control premium is associated with the 11% purchase and whether such a premium, if any, should also be attributed to the pre-existing 40% interest when evaluating the overall fair value of the business as well as the allocation of total fair value to the controlling and noncontrolling interests.

AcSEC also observes that the allocation of goodwill as described in paragraphs B154 and B155 will likely raise a number of implementation and valuation issues. As a result of the lack of precision that may be inherent in determining the fair value of business when less than 100% is acquired, AcSEC questions whether the prescribed method to allocate to the controlling and noncontrolling interests on other than a proportionate basis is operational.

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?

AcSEC agrees that the fair value of the consideration transferred by the acquirer on the acquisition date is the best evidence of fair value of the acquirer's interest in the acquiree.

However, AcSEC does not believe that the remeasurement of an existing interest is "consideration transferred." This is a remeasurement exercise, not a part of the exchange. Further, AcSEC has significant concern about the ability to reliably measure contingent consideration arrangements.

AcSEC believes that additional consideration paid to the seller to settle disparate views over fair value should be included in purchase price, except when such an arrangement is effectively a profit sharing arrangement or compensation to former selling shareholders. AcSEC shares some of the FASB's concerns that consideration determined after the date of the combination may be for reasons other than the fair value of the business at the date of the combination. In that regard, AcSEC would support enhancing the guidance surrounding the analysis of contingent consideration. AcSEC agrees that this analysis will require judgment, but believes this approach better reflects the substance of the arrangement.

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

AcSEC does not agree that contingent consideration should be remeasured to fair value at each reporting date, with the subsequent adjustments recognized in operating results. AcSEC generally believes that contingent consideration paid should be considered part of the business combination. While there are aspects of certain contingency arrangements that operate similar to profit sharing or compensation arrangements that should be recognized in operations post acquisition, AcSEC believes that most contingent consideration payments are fundamentally a part of the business combination. Additionally, the proposal to value the contingent consideration arrangement will be difficult to measure with sufficient reliability and, accordingly, will result in measurement error that will be captured in the income statement. AcSEC questions whether such an approach will enhance the user's understanding of the business combination and the contingency arrangements. Thus, AcSEC would be supportive of a model that enhances the guidance surrounding the judgments necessary to consider whether an arrangement is predominantly a profit sharing or compensation arrangement with former shareholders.

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?

AcSEC agrees that the costs that the acquirer incurs in connection with a business combination should not be included in the measure of fair value of the acquiree or the assets acquired or liabilities assumed as part of the business combination.

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?

AcSEC agrees with the following proposed changes to the accounting for business combinations:

- a. Receivables (including loans) acquired in a business combination should be measured at fair value.
- b. Costs associated with restructuring or exit activities that do not meet the recognition criteria in FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities, as of the acquisition date should not be accounted for as liabilities at the acquisition date and should be recognized as expenses when they are incurred.
- c. Particular research and development assets acquired in a business combination that previously were written off in accordance with FASB Interpretation No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, should be recognized and measured at fair value.

However, AcSEC is concerned with the practical application of the proposed guidance that would amend FASB Statement No. 5, Accounting for Contingencies, to exclude from its scope assets or liabilities arising from contingencies acquired or assumed in a business combination, and require these assets and liabilities to be measured and recognized at fair value at the acquisition date, and continue to be measured at fair value with changes in fair value recognized in income each reporting period. AcSEC notes that such an exercise will require an acquirer to record the fair value of remote or reasonably possible contingencies, often with no viable means of extinguishing such liabilities. When coupled with the need to separately track acquired contingencies versus those that are not acquired, this provision becomes difficult to operationalize and costly to implement and maintain. In effect, a company would be required to have two separate systems for identifying, recording and tracking contingencies. AcSEC recommends that any potential amendment to Statement 5 should be handled in a separate project outside the scope of this ED.

If the FASB continues with the proposed guidance that would amend FASB Statement 5, AcSEC recommends the final guidance should clarify, in paragraph 36, how insurance recoverable assets held by commercial enterprises should be accounted for. If the underlying claim obligations recorded by the enterprise are considered Statement 5 liabilities and continually measured at fair value, it would seem appropriate that the insurance recoverable asset should also be on the same basis.



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?

AcSEC agrees with the proposed exceptions to the fair value measurement principle, as noted in paragraphs 42 through 51 in the ED:

- a. Assets Held for Sale,
- b. Deferred Taxes,
- c. Operating Leases,
- d. Employee Benefit Plans, and
- e. Goodwill.

AcSEC requests clarification regarding what "assets held for sale" would qualify as an exception to the fair value measurement principle. If the exception is associated with an acquired long-lived asset that was classified as held for sale by the acquiree as of the acquisition date in accordance with Statement 144, AcSEC believes this needs to be clarified. However, if the exception is broader and extends to decisions made by the acquirer, AcSEC believes such an exception is not of a similar nature to the others noted.

AcSEC also requests clarification as to why operating leases are specifically highlighted as an exception to the fair value measurement principle. AcSEC also believes that other executory contracts may have characteristics similar to those of an operating lease and the inclusion of the operating lease exception could raise questions about whether other executory contracts should be separated into various elements.

AcSEC also believes that the FASB needs to directly address the accounting for assets not expected to be used by the acquirer (for example, tradenames or brands expected to be phased out or abandoned). Current practice generally records such assets based upon buyer-specific intentions. AcSEC notes that recognizing such assets based upon market participant assumptions would be a significant change in practice and requires guidance regarding the accounting for such assets after acquisition. For example, the subsequent impairment or amortization should be addressed in order to provide the necessary guidance.

AcSEC also recommends that the Board include postemployment benefit plans in the scope of FASB 112, Employer's Accounting for Postemployment Benefits, that are accounted for on an actuarial basis as an additional exception to the fair value measurement principle. These postemployment benefit plans are accounted for similarly to Statement 87 employee benefit plans, and accordingly should also be excluded from fair value measurement.

Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations

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?

AcSEC opposes the proposed accounting for business combinations achieved in stages where the acquirer recognizes in income any gains or losses on previously acquired noncontrolling equity investments on the date it obtains control. AcSEC fundamentally does not believe that a gain or loss is inherent in such a transaction.

However, AcSEC believes that a parent should reflect its ownership interests on the basis of its cost to acquire that ownership interest. The performance of this investment, its impairment testing and the gains and losses relative to the subsequent sale of such investment should be based on historical invested capital.

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?

AcSEC opposes 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. As a fundamental principle, AcSEC does not agree with the Board that a gain results from a purchase business combination unless a portion of the consideration transferred to the seller is an appreciated asset. In that case, an earnings process has occurred. AcSEC agrees with the Board that the consideration paid should be presumed to be the fair value of that portion of the business acquired; this presumption should not be altered merely by the fact that the purchase price allocation process yields an excess after defined assets and liabilities have been recorded. AcSEC believes that many such business combinations are not "bargains." They may involve situations in which both buyer and seller recognize that there are remedial actions that must be taken by the buyer, but are not liabilities. There may be other negative factors affecting the market value of the business or a particular industry that do not directly affect the fair values of the underlying assets or result in a liability. However, these are not gain transactions.

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?

AcSEC does not believe that such an overpayment could be measured reliably.

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?

AcSEC believes the proposed guidance is consistent with measuring the fair value at the date of the acquisition. However, as a practical matter, the valuation of assets acquired and liabilities assumed often times is a complex undertaking and requires some period of time. AcSEC does not believe that the cost and disruptive nature of such restatements is warranted for these types of adjustments. (AcSEC also observes that such adjustments could take place over a period of several quarters, resulting in multiple restatements.) However, AcSEC would be supportive of restating financial information when the weight of evidence suggests that the preliminary allocations were fundamentally flawed.

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?

AcSEC agrees with the overall principle that the business combination accounting should be confined to the exchange transaction and not be extended to other arrangements that might be entered into between buyer and seller. AcSEC appreciates the examples provided in paragraph 70 of the ED, and believes these examples are helpful in determining 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. AcSEC believes the language in EITF 95-8 about factors that are "a strong indicator that the arrangement is, in substance, compensation for postcombination services rather than additional purchase price" has been very helpful to practitioners and should be included in this final guidance. AcSEC also believes that this guidance should be consistent with the concepts in FASB Statement 146.

AcSEC agrees that only the consideration transferred and the assets acquired or liabilities assumed or incurred that are part of the exchange for the acquiree shall be included in the business combination accounting.

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?

AcSEC agrees with the broad disclosure objectives of the ED that are intended to ensure that users of financial statements are provided with adequate information to enable them to evaluate the nature of financial effects of business combinations.

AcSEC recommends that FASB consider whether all the noted disclosures in the ED should be required for private entities. Such entities, for which comparability may be less

of an issue than for larger public entities, may lack adequate staff or financial resources to readily apply the disclosure provisions of this ED, and may therefore place greater reliance on and incur greater fees from their outside accountant for assistance in the implementation and ongoing compliance.

AcSEC questions the following required disclosures in paragraph 72 of the ED:

D. The primary reasons for the business combination, including a description of the factors that contributed to the recognition of goodwill.

AcSEC agrees with the first part of the disclosure requirement in 72d. However, as goodwill is a residual by definition, the second part of the disclosure requirement appears to have limited informational value. AcSEC recommends that the current disclosure requirements articulated in FASB Statement No. 141 be retained. That guidance requires disclosure of "factors that contribute to the purchase price."

H. The maximum potential amount of future payments (undiscounted) the acquirer could be required to make under the terms of the acquisition agreement.

AcSEC believes a description of the contingency payments is often more relevant than disclosing the maximum potential amount of future payments. AcSEC agrees that disclosure in this area could be enhanced and would recommend disclosure of the nature of such arrangements and what milestones or other performance factors could trigger subsequent payments and their duration and amounts.

I. The amount of gain recognized in accordance with paragraph 61, the line item in the income statement in which the gain is recognized, and a description of the reasons why the acquirer was able to achieve a gain.

Consistent with AcSEC's view on the accounting required by paragraph 61, AcSEC does not believe a gain has occurred. Thus, AcSEC would recommend that the disclosure indicate why a gain was "recorded" rather than "achieved."

If the FASB concludes that a gain is recognized in accordance with the guidance in paragraph 61, then AcSEC agrees that the related disclosure should include the amount of the gain and where it resides on the income statement, but not a description of reasons why a gain is achieved as that is too subjective and would require speculation about the seller's motivation.

L. The amount of costs incurred in connection with the business combination, the amount recognized as an expense and the line item or items in the income statement in which those expenses are recognized.

AcSEC believes that this disclosure is not necessary, as these costs are not being accounted for as part of the business combination. If the disclosure is required, AcSEC believes it needs clarification. That is, it is not clear whether the disclosure

relates to payments made to third parties or whether it also covers direct and incremental costs incurred internally. AcSEC also observes that this disclosure seems to be more of a MD&A type disclosure as compared to information contained in the footnotes.

AcSEC observes that the requirement in paragraph 74 (a) of the ED to disclose revenue and net income of the acquiree since the acquisition date, may be difficult to track when systems are merged after a business combination. Some businesses integrate business functions after a business combination, making it difficult to ascertain the revenue associated with a previously separate business. Additionally, acquirers will often try to quickly rationalize sales forces, distribution systems, and other functions to achieve planned synergies.

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?

AcSEC believes that the Board should reconsider its conclusion that the fair value of workforce acquired in a business combination not be recorded as an intangible asset separate from goodwill. AcSEC notes that workforce is already valued in many cases for purposes of calculating a contributory asset charge when valuing other intangible assets. Further, due to the advances in determining fair values, AcSEC believes that this asset is capable of being measured.

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?

AcSEC agrees that any changes in the acquirer's deferred tax benefits that become recognizable as a result of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination.

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?

AcSEC believes that the disclosures related to business combinations should be the same for IASB and FASB standards. AcSEC believes the disclosures associated with a business combination and transactions with noncontrolling interests are important to users of financial statements. Thus, unless the disclosure would be inconsistent with another existing standard of either the IASB or the FASB, AcSEC recommends that disclosures be converged.

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?

AcSEC believes that the bold type may assist readers of the standard in identifying the underlying principles. Therefore, AcSEC is generally supportive of the approach. However, as all the guidance is considered authoritative and of equal status, AcSEC did not endeavor to analyze the whether the bolded print captures all the main principles.

COMMENTS ON OTHER ISSUES

- 1. AcSEC recommends that for ease of use, the final guidance include actual definitions in the standard, instead of references to other proposed standards.
- 2. AcSEC believes that due to the nature of the acquired assets there will be many Day 2 issues resulting from the implementation of the ED, and recommends that the final guidance include additional discussion related to such issues. Some of those issues were identified in Appendix A (for example, issues related to assets not expected to be used or to be abandoned). Some issues are also identified in Appendix C specifically related to insurance accounting.

Appendix B

RESPONSES TO SPECIFIC ISSUES:

Proposed FASB, Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries – a replacement of ARB No. 51.

Question 1: Do you agree that the noncontrolling interest is part of the equity of the consolidated entity? If not, what alternative do you propose and why?

AcSEC disagrees with the Board's decision to treat the noncontrolling interest (minority interest) as part of the equity of the consolidated entity. AcSEC acknowledges that the noncontrolling interests do not meet the definition of a liability under FASB Concepts Statement No. 6, but also believes that they do not meet the definition of equity because noncontrolling interests do not have an ownership interest in the consolidated entity. AcSEC believes the consolidated financial statements are prepared primarily for the benefit of the parent company stakeholders and, accordingly, believes that the consolidated equity should reflect the parent's equity. AcSEC supports classifying the noncontrolling interest on a separate line item on the balance sheet of the consolidated entity between liabilities and shareholders' equity. AcSEC also believes that the FASB should determine what is the most appropriate classification for the noncontrolling interest after readdressing the conceptual framework.

Question 2: Do you agree with the proposed requirement to present the noncontrolling interest in the consolidated statement of financial position within equity, separately from the parent shareholders' equity? If not, what alternative do you propose and why?

If the FASB were to continue supporting their consolidation model after completing its deliberations, AcSEC would agree with the proposed requirement to present the noncontrolling interest in the consolidated statement of financial position within equity, separately from the parent shareholders' equity. AcSEC believes it is important to users of the financial statements to clearly identify the interests of the various residual stakeholders, including the noncontrolling interests.

Question 3: Do you agree with the proposed requirements for attributing net income or loss and the components of other comprehensive income to the controlling and noncontrolling interests? If not, what alternative do you propose and why?

AcSEC generally agrees with the proposed requirements for attributing net income or loss and the components of other comprehensive income to the controlling and noncontrolling interests.

However, AcSEC does not agree with the Board's decision to allocate losses to the noncontrolling interest when such losses exceed the noncontrolling interest in the subsidiary's equity and result in a negative noncontrolling interest. AcSEC believes that the noncontrolling interest is not a part of consolidated equity and should not absorb losses beyond its interest in the subsidiary's equity. Additionally, AcSEC believes it is more representationally faithful to allocate such losses to the controlling shareholder.

Question 4: Do you agree that changes in ownership interests in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as equity transactions? If not, what alternative do you propose and why?

AcSEC does not believe that the purchase of an additional interest in a consolidated subsidiary is an equity transaction; AcSEC believes this is a purchase transaction that should be reflected as part of the parent's investment in the subsidiary. Likewise, AcSEC does not believe that the sale of a portion of a parent's interest in a subsidiary with independent third parties is an equity transaction; it is an exchange transaction for which a gain or loss should be recognized.

Question 5: Do you agree that any gain or loss resulting from the remeasurement of a retained investment in a former subsidiary should be recognized in income of the period? If not, what alternative do you propose and why?

AcSEC does not believe that a gain or loss should be recognized on the remeasurement of a retained investment. AcSEC believes that remeasurement of a pre-existing interest is a new basis issue that should be addressed in that context. Accordingly, AcSEC does not support this proposal.

Question 6: Do you agree with the proposed guidance for determining whether multiple arrangements should be accounted for as a single arrangement? If not, what alternative do you propose and why?

AcSEC supports the principle that requires preparers to assess whether multiple arrangements that result in a loss of control should be accounted for as a single arrangement. AcSEC also supports including factors to consider for determining whether multiple arrangements should be accounted for as a single arrangement. Additionally, AcSEC recommends the FASB provide guidance when such multiple arrangements span more than one reporting period.

Question 7: Do you agree that earnings per share amounts should be calculated using only amounts attributable to the controlling interest? If not, what alternative do you propose and why?

AcSEC agrees that earnings per share amounts should be calculated using only amounts attributable to the controlling interests and that the presentation of earnings per share information is primarily for the benefit of the controlling interest shareholders.

Question 8: Do you agree that disclosure of the total amounts of consolidated net income and consolidated comprehensive income, and the amounts of each attributable to the controlling interest and the noncontrolling interest should be required? If not, why?

AcSEC agrees with the requirement for disclosure of the total amounts of consolidated net income and consolidated comprehensive income, and the amount of each attributable to the controlling and noncontrolling interests.

AcSEC notes that International Accounting Standards currently require a statement of changes in equity. If U.S. generally accepted accounting principles had a similar requirement for such a statement, this would likely eliminate the need for separate disclosures. AcSEC also notes that many U.S. companies already prepare such a statement. Thus, the FASB may wish to consider whether convergence of the required financial statements would alleviate the need for additional disclosure requirements.

Question 9: Do you agree that disclosure of the amounts attributable to the controlling interest should be required? If not, why?

AcSEC agrees that disclosure of the amounts attributable to the controlling interest may be of benefit to the controlling shareholders and other primary users of the consolidated financial statements and therefore supports such disclosures. AcSEC agrees that similar disclosures should not be required for noncontrolling interests.

Question 10: Do you agree that a reconciliation of the changes in the noncontrolling interest should be required? If not, why?

AcSEC agrees that a reconciliation should be required of the changes in the noncontrolling interest from the amount reported in equity as of the beginning of each reporting period to the amount reported at the end of each reporting period. However, see additional commentary in Question 8 regarding the possibility of requiring a statement of changes in shareholders' equity that would encompass such a reconciliation if the FASB adopts the proposal to include noncontrolling interests in shareholder equity.

Question 11: Do you agree that disclosure of a separate schedule that shows the effects of any transactions with the noncontrolling interest on the equity attributable to the controlling interest should be required? Please provide the basis for your position.

AcSEC supports disclosures that would provide greater transparency of transactions with noncontrolling shareholders. This information is helpful to the shareholders and other users of the consolidated financial statements to better understand the economic impact of

investment decisions made by the parent. However, AcSEC is concerned that the earnings per share disclosures will be confusing, as they do not necessarily represent transactions which are the results of the earnings process. For example, AcSEC does not believe that the purchase of an additional interest in a subsidiary from a noncontrolling shareholder should affect earnings per share. On the other hand, AcSEC does believe that the sale of an interest in a subsidiary (yet still controlled) is a transaction that is reflective of performance.

Question 12: Do you agree that disclosure of the gain or loss recognized on the loss of control of a subsidiary should be required? If not, why?

AcSEC agrees that disclosure of the gain or loss recognized on the loss of control of a subsidiary should be required.

Question 13: Do you agree with the proposed transition requirements? If not, what alternative do you propose and why?

AcSEC is in support of the proposed transition requirements. AcSEC is supportive of the goal to improve comparability of financial information, and agrees with the requirement of retrospective application of the presentation and disclosure requirements of the ED. AcSEC also agrees that retrospective application involving recalculation of prior amounts would be impracticable.

Appendix C

Proposed FASB, Business Combinations: a replacement of FASB Statement No. 141 - Insurance Specific Comments

In December 2003, the Planning Subcommittee of AcSEC and the AICPA Insurance Expert Panel requested that the FASB consider several significant issues related to business combinations by insurance enterprises prior to the release of this exposure draft.

AcSEC has the following insurance entity specific concerns that AcSEC believes should be clarified or addressed in a final standard.

AcSEC appreciates the proposed guidance in paragraph 36 of the ED that appears to be directly applicable to insurance enterprises that states:

- 36. After initial recognition, contingencies shall be accounted for as follows:
- a. A contingency that would be accounted for in accordance with Statement 5 if it were acquired or incurred in an event other than a business combination shall continue to be measured at fair value with any changes in fair value recognized in income in each reporting period.
- b. All other contingencies shall be accounted for in accordance with generally accepted accounting principles. For example:
 - (1) A contingency that is a financial instrument shall be accounted for in accordance with applicable financial instrument guidance.
 - (2) A contingency that is an asset or liability arising from an insurance contract shall be accounted for in accordance with FASB Statement No. 60, as amended (including the intangible asset, if any, recognized for the difference between the amounts recognized on the acquisition date at fair value and the amounts that would be recognized in accordance with Statement 60).

Scope of Paragraph 36:

AcSEC believes there is significant confusion as to which contracts, in whole or in part, should be considered contingent liabilities and accounted for under paragraph 36 of the ED. AcSEC recommends that the FASB modify the wording in paragraph 36 (b)2 to include all contracts covered by insurance guidance:

(2) A contingency that is an asset or liability arising from an insurance contract shall be accounted for in accordance with FASB Statements No. 60, 97, 113 or other appropriate literature (including the intangible asset, if any, recognized for the difference between the amounts recognized on the acquisition date at

fair value and the amounts that would be recognized in accordance with Statements 60, 97 or 113).

AcSEC believes that acquired Statement 113 reinsurance recoverables should be included as a contingent asset under the guidance in paragraph 36 b(2) of the ED, as that would result in consistent accounting between the insurance recoverable and the direct claim liability of an insurance company.

Contingent Commissions:

AcSEC also requests clarification as to whether assumed contingent commissions payable to brokers are intended to be included as a contingency arising from an insurance contract, and accounted for under paragraph 36 b(2) of the ED. As the transaction is not between an insurance company and insured, but rather an insurance company and a broker, it is not clear whether the contingent commissions payable to the broker is considered to be a contingency arising from an insurance contract. Paragraph 44 of Statement 60 discusses that separate liabilities should be accrued for retrospective commissions or experience refund arrangements based on experience and provisions of the contract and seems to infer that the liability arises from the insurance contract.

Definition of a Business Combination:

AcSEC also questions how loss portfolio transfers (with or without novation) or other transfers by contract would fit into the proposed definition of a business combination, and requests clarification for these situations.

Risk Transfer:

AcSEC also recommends that the final guidance clearly state that the risk transfer assessment and determination of contract classification (retroactive or prospective) of acquired insurance or reinsurance contracts are not meant to be re-evaluated as of the acquisition date using assumptions appropriate on that date unless the terms of the insurance or reinsurance contract are modified as the result of the business combination. AcSEC believes that the acquisition of insurance or reinsurance contracts in a business combination should not be considered a contract amendment requiring reassessment of risk transfer or classification, as the acquirer is merely stepping in the shoes of the acquiree.

Contract Inception:

For Statement 97 deferred acquisition costs, SOP 03-1 minimum death benefit liabilities, and other instances where it is necessary to consider all activity back to the inception of the contract and retrospectively adjust the balances. It is unclear in the ED if the acquirer should continue using activity from inception of the contract or just from the acquisition date. AcSEC recommends that the final guidance should state that for these purposes the acquisition date should be considered the inception of the contract.

Premium Deficiency:

AcSEC recommends that the amendment to paragraph 33 of Statement 60 in paragraph D13 of the ED should be revised as follows:

A premium deficiency shall be recognized in the sum of expected claim costs and claim adjustment expenses, expected dividends to policyholders, unamortized acquisition costs, the portion of the <u>intangible assets related to the acquired unearned premium</u>, and maintenance costs exceeds related unearned premiums.

AcSEC believes that the original proposed wording was written too broadly and implied that all intangible assets related to short-duration contracts should be included in the premium deficiency test. The revised wording is meant to eliminate any possible double counting by specifically stating the intangible assets included only relate to the unexpired short-duration contracts.

Day 2:

The December 2003 letter also requested that the FASB address Day 2 issues,. For example, the letter noted that in accounting for acquisitions of short-duration contracts, a common approach under current practice is to measure the liabilities for claims and claim adjustment expenses at their nominal value with the difference between the nominal value and the fair value of the liabilities (essentially the fair value adjustment of the net cash flows embedded in the acquired liabilities, the impact of the risk free discount rates, the risk premium and the credit adjustment, to the extent applicable) recorded as the "net fair value adjustment on acquired liabilities" or a similar distinguishable account similar to a debt discount. At the acquisition date, the sum of these two components will equal the fair value of the liabilities.

However, there is diversity in subsequent post-purchase accounting. The fair value adjustment on claims and claim adjustment expenses should be accreted and reported as part of losses incurred in the statement of operations, using an effective interest method, over the estimated remaining settlement period on the policies acquired. However, changes in the timing and/or ultimate amount of claims to be paid need to be addressed in the accounting for the fair value adjustment.

AcSEC requests that for purposes of consistency, the final guidance should discuss how the intangible asset (the difference between the amounts recognized on the acquisition date at fair value and the amounts recognized in accordance with the appropriate accounting guidance, such as Statements 60 and 113) should be accounted for after the initial acquisition or note if there will be an additional project to discuss such Day 2 issues. For long-duration contracts the asset should be amortized in accordance with EITF 92-9, and no additional guidance is needed.

AcSEC currently has a project to update the AICPA Property and Liability Insurance Audit and Accounting Guide., The Property and Liability Guide task force has included Day 2 business combination issues as a significant area lacking guidance, and would plan to develop an issues paper if not addressed in the final FASB business combination guidance. If the FASB wishes to address these issues in a final standard, as AcSEC

recommends, AcSEC volunteers to form a task force to work on developing such guidance in conjunction with the FASB staff.