To:

Financial Accounting Standards Board

From:

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Letter of Comment No: ///

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RE:

File Reference 154-D - Consolidated Statements

Please accept the enclosed comments on the recent exposure draft on consolidated statements. The comments are based on my experience in dealing with the viewpoints of the professors who comment on our text, <u>Advanced Accounting</u> (Fischer and Taylor, Southwestern Publishing Co.), which is now in its 6th edition.

Proposed Changes to the Exposure Draft on Business Combinations

Based on a careful review of the Exposure Draft, I would strongly recommend the following changes:

- 1. Where negative goodwill results from the price paid by the controlling interest, the noncontrolling share of fixed assets should be recorded at the same percentage of market value as the controlling share. This means that both the controlling and noncontrolling interests would be discounted when the price paid results in negative goodwill.
- 2. The noncontrolling share of pre-existing goodwill of the subsidiary should be retained to the extend that the book value of the noncontrolling interest exceeds the sum of the assigned market values recorded for the noncontrolling share of net assets.
- 3. Push-down accounting should be required. This would require the recording of assigned market value on the statements of the subsidiary.

Supporting Arguments:

1. Where negative goodwill results from the price paid by the controlling interest, the noncontrolling share of fixed assets should be recorded at the same percentage of market value as the controlling share. This means that both the controlling and noncontrolling interests would be discounted when the price paid results in negative goodwill.

It seems inappropriate to increase the noncontrolling share of fixed assets to full market value in a purchase where the price paid is so low as to result in negative goodwill. The fact that the price paid by the controlling interest exceeds the market value of the controlling share of identifiable assets suggests that the estimated market value is overstated. The price paid for the controlling interest does not ratify the estimated market value. In such a case, it would appear that the estimated market values should not be relied upon to the extent that they be recorded, rather they are only used as allocation weights to allocate the price actually paid. This procedure is common practice for group purchases of fixed assets or inventory.

If the price paid for the controlling interest allows only 90% of the controlling share of the market value of identifiable assets to be recorded, then it would seem that only 90% of the noncontrolling interest's share of the market value of the identifiable assets should be recorded. Simply stated, if the controlling interest would not pay 100% of market value for its portion of these assets, why would we record 100% of market value of the noncontrolling interest in these assets which has not been sold? It would appear that the price paid suggests that the real market value of the identifiable assets is 90% of the estimated market value.

The method proposed in the ED assumes that estimated market values are more reliable than the actual price paid. It further assumes that the controlling interest actually purchased below market

value. If that is true, then record negative goodwill(the bargain) and simply allocate it over an appropriate time period. Don't bother with an allocation of the bargain to identifiable assets which reduces the relevance of the value assigned these assets.

Example: Accounting for Purchase with Negative Goodwill

Extending the example in Par. 27 of the ED, assume that the parent company pays \$1,500,000 for a 90% interest in the subsidiary. Comparing this price to the \$1,800,000 market value of its interest results in negative goodwill on the controlling interest of \$300,000. The ED would discount only the controlling share of the identifiable assets by \$300,000 and would lead to the following impacts on the consolidated balance sheet:

Identifiable asset:

Controlling(.9 X 3.6 mil - \$300,000)	\$2,940,000	Liabilities	\$1,600,000
Noncontrolling(.1 X 3.6 mil)	360,000	Noncontolling Equity	200,000
		Controlling equity(price paid)	1,500,000
Total assets	\$3,300,000	Total liabilities and equity	\$3,300,000

The alternative method discounts the noncontolling interest in the identifiable asset in the same proportion as the controlling interest. This discount is .0926(300,000/3,240,000) which means the identifiable asset will be recorded at .9074 times market value:

Identifiable asset:

Controlling(.9 X .9074 X \$3,600,000)\$2,940,000		Liabilities	\$1,600,000
Noncontrolling		Noncontrolling equity	
(.1 X .9074 X \$3,600,000)	326,665	(\$200,000 - \$33,335 asset a	dj.) 166,665
		Controlling equity	1,500,000
Total assets	\$3,266,665	Total liabilities and equity	\$3,266,665

2. The noncontrolling share of pre-existing goodwill of the subsidiary should be retained to the extend that the book value of the noncontrolling interest exceeds the sum of the assigned market values recorded for the noncontrolling share of net assets.

The ED appears to say that in an under 100% purchase, the noncontrolling share of identifiable assets and liabilities are recorded at market value no matter the price paid(including purchases with negative goodwill). Though not explicitly stated, it appears that no goodwill, including pre-existing goodwill is recorded relative to the noncontrolling interest. This means that the noncontrolling share of pre-existing goodwill is reassigned to identifiable assets. It could mean that, if the share of goodwill eliminated exceeds the asset increases, the noncontrolling interest could be reduced in total. This appears to deny the noncontrolling interest an asset(pre-existing goodwill) that they paid for.

3. Push-down accounting should be required. This would require the recording of assigned market value on the statements of the subsidiary.

Push-down accounting would require that all accounts would be recorded on the subsidiary's books at assigned market value. There are three advantages I see to this procedure:

- 1. It assures that all assets and liabilities are recorded at market value (or discounted market value for fixed assets where the price paid reflects negative goodwill).
- 2. It is efficient, once the adjustment is made on the subsidiary's books, it need not be repeated each year(and possibly altered) in the consolidation process. Amortization would also be automatic.
- 3. It would provide better information to the noncontrolling shareholders and creditors of the subsidiary. They would share the view point of the controlling interest as to commonly used ratios. Both interests would be appraising performance using the same relevant(market based) measures.