Letter of Comment No:
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Technical Director
File Reference 1204-001
FASB
Norwalk CT

Ladies and Gentlemen:

This letter is being written on behalf of Marshall & Stevens, the country's second oldest firm of professional valuation consultants, with an international clientele and a lot of experience in the valuation of Business Combinations for our clients. Our answers to the questions you asked in your ED are shown in order.

Question 1. On the surface the ED's objectives and definition of a business combination appear reasonable and appropriate. We have no experience that would suggest otherwise.

Question 2. We have had experience, mostly unfortunate, with EITF 98-3, and are glad to see your proposed revision. We have no reason, based on experience to date, to believe that there is any need to modify or clarify your guidance.

Question 3. We are strongly supportive of your proposed change. Trying to work with book values that consist, for example, of 40% original cost and 60% Fair Value (FV) is a nightmare. Your proposal is going to greatly simplify the valuation efforts of appraisers. Our one caveat relates to the fact that if an acquirer obtains 60% of a business for $60 million this does not mean that the FV of the total acquired business is $100 million. It could be higher, or lower, depending on the facts and circumstances which would include several variables. We believe that this point should be made crystal clear in the final Standard, to avoid future controversies with auditors and/or SEC who might want a straight numerical or mechanical grossing up.

Question 4. As long as the objective is the determination of the FV of 100% of the acquiree, and an appraiser can apply his judgment based on the facts and circumstances then A8 –A26 should be sufficient.

Question 5. We agree that contingent consideration can be valued and considered part of the acquisition FV and that the acquisition date, not the announcement date, is the best base for measurement. **We are prepared to discuss the valuation of contingent consideration at the public hearing, or at a prior time convenient to the Board.**

Question 6. As noted above, the argument that contingent consideration can not be valued if the parties themselves can not agree is bogus. We as appraisers are often retained by both sides to a valuation dispute, such as a buy and sell agreement, that calls for an independent valuation. We can always determine a Fair Value. We know we are pretty close when both sides dislike our answer(s)!

Question 7. While this question probably falls outside our area of valuation expertise, we do disagree strongly with your conclusions. Every acquirer of a company, potential or actual, is going to incur accounting, legal and valuation expenditures. Put a different way, there is no way a significant business combination can occur without such expenditures. Now it is true that legal fees incurred in acquiring a company don't directly add value to individual assets, but they are absolutely required for the acquisition to proceed.

One of the fundamental principles of accounting is that the **cost** of an asset, the resources expended, represents the minimum value of that asset to the acquirer - at least on Day 1. If you go down the path of expensing legal, accounting and valuation fees, the next logical step is expensing inbound transportation, installation and debugging of machinery and equipment. You can define Fair Value any way you want to, but common sense for most businessmen, is that they believe that the cost to get an asset up and working is its value to the business.

This essentially boils down to a value in-use vs. a value in-exchange premise. Your original thought process, the way earlier drafts were written, seemed to call for a value in-exchange for machinery and equipment. You realized the fallacy of that approach when it was brought to your attention. The same concept holds here. The Fair Value of a company to an acquirer has to equal or exceed the **total** cost, the consideration plus all out-of-pocket expenses. Defining the value of a business, without consideration of expenses incurred in doing the deal, is the first step on a very slippery slope. Please re-think your approach regarding transaction costs. I promise you that if you persist in this approach there will be severe unintended consequences.

Question 8. With regard to your proposed change in dealing with contingent liabilities I am sure you will receive numerous comments that these liabilities can not, or should not, be valued. I believe they should be valued, and can be valued. You are fully aware that because of the uncertainties inherent in such valuations that there will be strong pressure by companies for appraisers to take a 'conservative' approach. In effect, if the ultimate outcome is less than was put on the balance sheet there will be a pick-up in income –

which most companies will view as desirable. And because nobody "knows" on Day 1 what the outcome of lawsuits will be (think of the lawsuits against Merck on Vioxx or against Altria for tobacco-related deaths) all other things being equal companies (and appraisers) will err on the side of safety. Then when the uncertainty or contingency is resolved there can and probably will be 'second guessing' by plaintiff's lawyers and the SEC, asking "Why did you assume....?" Our only answer as appraisers is going to be to have good work papers, clearly stating our assumptions and the basis for those assumptions. At that point a contemporaneous decision, if it were made without bias, is likely to prevail. As with our answer to Question 5, **we are prepared to discuss the valuation of contingencies at the public hearing, or at a prior time convenient to the Board.**

Question 9. We have no real expertise in this area, other than with assets held for sale. In our opinion you have the correct answer there.

Question 10. We have no opinion on this subject. It is a straight accounting issue, not a valuation issue.

Question 11. Other than for the fact that there is potential for abuse, the accounting seems theoretically correct. There may well be more 'bargain purchases' in the real world than you are assuming, even allowing for contingent liabilities. In our practice we do see a number of situations where, for one reason or another, the seller is willing to accept less than we would deem to be the Fair Value. Waiting to achieve true FV as a seller, may involve a significant wait for the 'right' buyer to come along. The old adage "A bird in the hand is worth two in the bush" is particularly apt and may explain the significant number of bargain purchases we run into.

Question 12. The answer to the question, can we reliably measure the overpayment, is that as appraisers we can substitute our judgment for that of our client. We see numerous examples where we believe the buyer paid 'too much', or more than FV. However, having said that, we have yet to meet a client who is willing to go on record admitting they made a mistake. No CEO we have ever run into has been willing, on Day 1, to tell his shareholders he overpaid. Invariably they will wait for a period of time and then explain an impairment charge in terms of 'changed conditions'. While not necessarily in our area of expertise we believe that it would be opening 'Pandora's Box' to even permit companies to take an immediate writedown.

Question 13. We do not have an opinion on the adjustment of already issued financial statements, but your proposed rule will make it more difficult to 'fine tune' the values of specific hard-to-determine assets. In other words, companies will first present 'estimates' of FV; if these subsequently change and your rule is in effect, companies will resist

having to restate by simply accepting the original estimates as correct even if they are marginally wrong. The choice is between a higher degree of precision by using later information and paying the price by having to restate. Many clients will choose not to restate and defend this position by saying the new and later values are changing by less than 'material' amounts. Who then will determine materiality? Your proposed accounting treatment appears to be theoretically correct but will have perceived operational problems for many companies.

Question 14. We have never run into this problem and have no insight. The rule may lead to a problem in defining whether future payments to the seller's principals are for compensation for future services. This gets into non-compete agreements and how they are worded. On balance, if payments are clearly not for future services they appear to properly be considered part of the transaction price. The issue then becomes how much real work the sellers will perform for the buyer in exchange for future payments. This is likely to be an area where it is difficult for a third party – an appraiser or an auditor – to make an independent judgment.

Question 15. The proposed disclosures are already quite comprehensive and we have no recommendations for additional disclosure.

Question 16. The valuation of intangibles, whether of indefinite life or not, always involves a degree of uncertainty, which we overcome by clearly stating the assumptions we use. Put a different way, we can always come up with a FV for any identifiable intangible; different valuation specialists or auditors may question our assumptions, and/or may themselves come up with different answers. But that we can come up with *an* answer is incontrovertible.

In many years, and hundreds of allocations, we have always been able to develop a value for each recognized asset. In other words we have never been stumped, but reasonable people have, sometimes successfully, challenged our approach or assumptions. Thus, in answer to your question, we have no examples that can not be separated from goodwill.

Question 17. We rely on our clients and their auditors for guidance on all deferred tax issues and have no opinion on this issue.

Question 18. A review of the differences in Appendix F does not suggest any changes are required on the part of either FASB or IASB. The differences appear relatively minor and we have had no experience where one approach or the other would have affected our valuation work.

Question 19. We favor using the bold type as shown in the ED.

Please feel free to contact the writer at (540) 972-4704 for further explanation of any of the points made. My e-Mail address is: alfredking@erols.com.

Respectfully submitted,

/s/ Alfred M. King

Alfred M. King, Vice Chairman
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