

October 28, 2005

Technical Director – File Reference 1204-00
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Letter of Comment No: 39
File Reference: 1204-001

RE: Proposed Statement of Financial Accounting Standards, “Business Combinations – A Replacement of FASB Statement No. 141.”

Dear Director,

This letter is written on behalf of the Michigan Credit Union League (MCUL) as a response to the Financial Accounting Standards Board’s (FASB) Proposed Statement of Financial Accounting Standards, “Business Combinations – a replacement of FASB Statement No. 141” (the “Proposal”). MCUL is a trade association representing over 90% of state and federally chartered credit unions in the state of Michigan. This comment letter was drafted in consultation with the MCUL Government Affairs Committee, which is comprised of Michigan credit union staff and officials.

MCUL strongly opposes the adoption of the purchase method of accounting for mergers of cooperatives, which includes credit unions, and believes that the pooling method is a more accurate reflection of credit union mergers. Understanding that this accounting change is likely to occur, MCUL offers further comments and suggestions to address the questions explored in FASB’s Exposure Draft that are more fully described herein.

Summary of Comments

- MCUL does not believe that the statement provides sufficient guidance for measuring the fair value of an acquiree due to the unique nature of credit union mergers.
- MCUL does not support FASB’s proposed treatment that the costs that the acquirer incurs in connection with a business combination -- for example: valuation costs, legal fees and accounting fees -- are not assets and generally should be expensed.
- MCUL does not support the proposal’s creation of a separate equity classification on the financials of the acquiring institution for the amount equal to the fair value of the acquiree. We believe that this does not adequately reflect the new entity’s net worth and may cause unnecessary confusion.

Discussion

MCUL believes that the purchase method of accounting is not appropriate for the mergers of credit unions or other cooperatives. Circumstances surrounding credit union mergers are often different from those surrounding the mergers of other entities, due to the following factors:

- Credit unions are relatively small and tend to be structurally and operationally similar to each other, making it easier to combine the balance sheets of two credit unions than two different types of enterprises;
- It is not typical for either the depositors (members) or the management of the acquired credit union receive cash or securities in the transaction. (In few cases, mergers result in a portion of the remaining equity being paid in the form of a special dividend to the members, provided the credit union is well capitalized enough);
- No new capital is invested by members of either credit union as a result of the combination;
- The negotiations surrounding the merger do not have a “purchase” focus (i.e., there is no bargaining related to the market values of each of the combining credit unions); and
- Individual shareholder members are unable to gain control of the surviving credit union.

In addition, credit union mergers can occur for a wide variety of reasons. Often, either the federal or the state regulators promote the merger if a credit union is experiencing serious financial difficulty. Additionally, credit union mergers frequently occur when a small credit union opts to merge with a larger credit union to create greater economies of scale. These kinds of merger discussions may be prompted by a shrinking field of membership due to sponsor-related issues, a change in management, or a perceived need to offer a greater variety of services to its members than one credit union alone can afford. In any of these cases, we do not believe that the purchase method of accounting will accurately reflect the accounting transaction that occurs in these situations.

MCUL Opposes the Proposed Method of Measuring the Fair Value of the Acquiree. Because there is no one receiving cash or stock as a result of the transaction, no new capital invested, and there is no “purchase price,” there is no way for the market to provide accurate information to base the value of the acquiree. As a result of a lack of concrete ways to analyze the fair value, the methods used to determine the fair value of the acquired credit union could differ greatly from merger to merger, which would not benefit credit unions or their members. Credit unions differ in structure from most other financial institutions and thus there is no acceptable method currently available to value an acquired credit union.

Currently, while most credit unions determine if they are compatible to merge, many do not feel the need to utilize outside accountants to perform an economic analysis of the value of the credit unions. Because credit unions are more interested in determining whether their institutions are well-matched from a philosophical, operational, and “field of membership” standpoint, the focus is not on determining their combined value. Requiring an economic analysis of the merger may prove to be a significant expense on the two merging credit unions, without providing any significant value.

MCUL Opposes Expensing Costs Incurred During Business Combinations. FASB has initially proposed that the costs the acquirer incurs in connection with a business combination -- for example: valuation costs, legal fees and accounting fees -- are not assets and generally should be expensed. MCUL disagrees with this conclusion.

As paragraph B-97 of the Proposal indicated, “acquisition-related costs, including costs of due diligence, are an unavoidable cost of the investment in a business...since the acquirer intends to recover its due diligence cost through the postacquisition operations of the business, that transaction cost is a cost that should be capitalized as part of the total investment in the business.” It is not unreasonable for the cost of an asset to include both the fair value of the asset as well as the

acquisition costs. By acknowledging this fact, a seller might be inclined to accept a price less than “fair value” in order to sell the business.

As mergers are usually undertaken with the idea that it is a positive step for the two organizations, these costs should not be looked at as expenses but as part of the asset. FASB should continue to consider these costs in the same way that it has historically viewed other assets, which include the costs necessary to bring the complete asset to its intended use. Costs such as valuation costs, legal fees and accounting fees should continue to be viewed as assets and continue to be capitalized and amortized over the suitable accounting period.

MCUL Opposes Acquired Equity. MCUL has always argued that it is unnecessary to create a new accounting category for the merged credit union under acquired equity. The easier way to handle this has been to continue to combine the value of both institutions under the category of undivided or retained earnings. By creating a separate equity classification for the acquiring institution, it creates unnecessary confusion and regulatory problems for credit unions, without adding value.

It is better that the section of balance sheets dealing with equity be kept clear and uncomplicated. If there is no meaningful difference in acquired equity, then it makes more sense that they continue to be regarded as undivided or retained earnings.

We thank you for the opportunity to comment.

Sincerely,



Matthew Beard
Regulatory Specialist
Michigan Credit Union League

cc: Credit Union National Association, Inc.