Letter of Comment No: 53
File Reference: 1204-001

October 28, 2005

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1204-001—Proposed Statement of Financial Accounting Standards, *Business Combinations*, a replacement of FASB Statement No. 141

Dear Ms. Bielstein:

Washington Mutual, Inc. is a diversified financial services company with over \$330 billion in total assets as of September 30, 2005. Based on those total assets, Washington Mutual is the largest savings institution and one of the largest financial institutions in the United States. It also is one of the largest residential mortgage loan originators and mortgage loan servicers in the nation. We appreciate the opportunity to comment on the proposed replacement of FASB Statement No. 141 regarding the accounting for business combinations.

Generally, we support the Board's endeavor to clarify the accounting for business combinations. However, we believe that some of the proposed guidance, particularly with respect to the prohibition against the recognition of a valuation allowance for loans with credit losses, would significantly impair transparency for readers of financial statements. Our concerns are expressed in more detail below.

Question 8—Measuring and Recognizing the Assets Acquired and the Liabilities Assumed

Allowance for Loan Losses

Paragraph 34 states that "the acquirer shall not recognize a separate valuation allowance as of the acquisition date for assets required to be recognized at fair value in accordance with this Statement." The premise for this proposed guidance is that expected credit losses should be reflected in the fair value measurement of the related loans.



We believe that the result of the proposed guidance would make it virtually impossible for analysts, banking regulators, and other users of financial statements to properly assess whether a financial institution has an adequate allowance for loan losses after the acquisition date. If one financial institution acquires another financial institution in a business combination, the result of the proposed guidance would be that a significant portion of the combined loan portfolio would have a discounted carrying value rather than an explicit allowance for loan losses as of the acquisition date. Consequently, the reported amounts for the combined loan portfolio would be incomparable and difficult to analyze.

Although the entity initially could disclose the amount of the discount attributable to expected credit losses as of the acquisition date, it would be almost impossible for a reader of the financial statements to ascertain thereafter what portion of those credit losses embedded in the carrying value of the acquired loans remain outstanding. Trends related to charge-offs, ratios of the allowance versus outstanding loan balances, and other loan performance factors would be distorted after the acquisition. While the Board believes that supplemental disclosures could solve the inconsistent reporting, we believe that over time, as the carrying value and credit quality of those loans change, it will become virtually impossible to track and report the remaining discount that originally was recorded in a meaningful manner. If multiple acquisitions occur, the problem would be exacerbated.

If the acquired allowance for loan losses is properly stated at the time of acquisition, we believe that the risk of a significant reversal after the acquisition date would be small, as estimated credit losses generally are realized in the future. Nevertheless, to avoid that situation, we would support guidance that would not permit an acquired allowance for loans losses to be reversed into earnings until the related cash flows were received. In other words, we would expect the recorded (net) carrying value of the loan to be fully recovered before any additional cash flows received related to the outstanding principal balance were applied to reduce the acquired allowance for loan losses.

We believe that permitting and entity to carry over an acquired company's allowance for loan losses would be much easier to apply operationally and would provide financial information that is more transparent and meaningful to readers of financial statements. In informal discussions with regulators and analysts, we have found that most of them would prefer to continue the existing accounting practice with regards to acquired loans and the related allowance for loan losses. While we acknowledge that such an approach might not be perfect choice on a purely conceptual basis, we believe that the benefits of greater transparency would far outweigh the costs (e.g., incomparability and less meaningful results).



Question 7—Acquisition-related costs

The proposed guidance would exclude acquisition-related costs from the measurement of the consideration transferred for the acquired entity because those costs are not part of the fair value of the acquired entity and are not assets. Paragraph 20 states that "the exchange price . . . paid by the acquirer on the acquisition date is presumed to be the best evidence of the acquisition-date fair value of the acquirer's interest in the acquiree." We believe that acquisition-related costs should be considered part of the exchange price paid by the acquirer for the acquiree. Those costs are no different than a sales commission that is embedded in the price paid to purchase an asset. In evaluating the fair value of a target company, a potential buyer factors in the costs that are necessary to execute that transaction. Consequently, we believe that they should be considered part of the purchase price that is negotiated by a willing buyer and reflective of the fair value paid to acquire the target entity. Because those costs arise solely in contemplation and as a result of the business combination, we believe that it would be more appropriate to include them as part of the cost of that acquisition rather than reflect them as period or operating costs.

Summary

While we support the additional guidance regarding the accounting for business combinations, we believe that the Board should remove the prohibition against the recognition of an allowance for loan losses related to acquired loans or receivables. An allowance for loan losses is a contra asset. Consequently, it is part of the carrying value of the related loans. Recording that allowance separately for acquired loans would not prevent those loans from being recognized at fair value. However, it would provide greater transparency by maintaining a comparable accounting basis for both originated loans and acquired loans that would be more meaningful to readers of the financial statements.

We appreciate the opportunity to comment on the proposed guidance. If you have any questions, please contact me at 206-377-3684 or larry.gee@wamu.net.

Very truly yours,

Lawrence R. Gee Senior Vice President and Deputy Controller