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October 17, 2005

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
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Letter of Comment No: 12 File Reference: 1204-001 Date Received: 10, 19, 05

Re: File Reference No. 1204-001- Exposure Draft - Business Combinations a replacement of FASB Statement No. 141

Dear Sir or Madam,

We, Dr. Nathan S. Slavin and Abu R. Khan, are pleased to comment on FASB Proposed Statement of Financial Accounting Standards Business Combinations a replacement of FASB Statement No. 141, file reference number 1204-001 as members of the general public.

Our comments are on the elimination of disclosure requirements proposed by paragraph B186 (f) of the Exposure Draft in connection with recognized in-process research and development (IPR&D) assets. We believe the proposed disclosure requirements are inadequate and should be amended to require the disclosure of management's key assumptions; especially, the discount rate and expected cash flow projections used for the valuation of the IPR&D asset.

Our comments are based upon our recent study on IPR&D. We studied a random sample of 380 business combinations with IPR&D charges from 1996 to 2004 in order to determine whether the SEC's intervention in 1998 and the introduction of SFAS 141 and 142 in 2001 had any effect on the valuation of IPR&D. As a by-product of this study, we have discovered that the assumptions used to value IPR&D projects are not adequately disclosed in annual reports following a business acquisition. Only 55 of the 380 business combinations from our sample (14.5%) disclosed the discount rates used to value recognized IPR&D assets. The disclosed discount rates ranged from 13% to 60%. The mean and median discount rates were 28.78% and 30% respectively. Substantially

fewer companies disclosed their assumptions on expected cash flows from recognized IPR&D assets.

We believe disclosure is a key issue in IPR&D assets because the nominal values of IPR&D assets are not comparable without their underlying key assumptions like discount rates and expected cash flows. An IPR&D asset with an even cash flow stream of \$53.69 million over 14 years can be valued at \$322.2 million. The value of the IPR&D declines to \$133 million when a 40% discount rate is used. The valuation significantly changes if the timing and nature of the expected cash flow change. We recognize no two IPR&D projects are alike. Management must make different discount rate and cash flow assumptions depending on the IPR&D project and prevailing market conditions. However, without adequate disclosure of these assumptions, the usefulness and comparability of financial information regarding IPR&D assets diminish significantly, even to a sophisticated user.

IPR&D should be distinguished from other intangible assets because of its potential to generate income without matching expenses. The current proposal for the amortization of an IPR&D asset is certainly an improvement over FASB Interpretation No. 4, which requires the immediate expensing of it. Under the current proposal, some amortization expenses will be charged against the revenue generated by an IPR&D project. However, the net income will not be comparable if further disclosure is not required. Specifically, identical values assigned to two alternative IPR&D projects may result in diverse future income streams. We assume the following to demonstrate our point,

Similar companies P1 and P2 purchase companies S1 and S2 respectively,

- P1 recognizes an IPR&D asset of \$200 million assuming a discount rate of 14% and even cash flows from year 2007 to 2011.
- P2 recognizes an IPR&D asset of \$200 million assuming a discount rate of 28% and even cash flows from year 2007 to 2011.
- In the beginning of 2007, both IPR&D projects are successful, management's cash flow assumptions are proven correct and both assets' useful lives are estimated to be five years each.

Although both IPR&D assets have the same nominal value, and the same amortization expense of \$40 million per year, the IPR&D asset recognized by Company P1 will generate \$18.26 million income for five years compared to \$38.99 million income for Company P2 (See Table 1 & 2). The difference in income is attributed to the selection of the discount rate.

Table 1: Net Income from IPR&D Asset under New Rule for Company P1

	COMPANY P-1		
Discount Rate	14.00%		
Year	Incremental Income from IPR&D	Less: IPR&D Amortization Expense	IPR&D Contribution to Net Income
2007	58,257	40,000	18,257
2008	58,257	40,000	18,257
2009	58,257	40,000	18,257
2010	58,257	40,000	18,257
2011	58,257	40,000	18,257
Total	291,284	200,000	91,284
IPR&D Value	200,000		

Table-2: Net Income from IPR&D Asset under New Rule for Company P2

Discount Rate Year	COMPANY P-2	and the production of the state	Sandy-value-vallo-
	28.00%		
	Incremental Income from IPR&D	Less: IPR&D Amortization Expense	IPR&D Contribution to Net Income
2007	78,989	40,000	38,989
2008	78,989	40,000	38,989
2009	78,989	40,000	38,989
2010	78,989	40,000	38,989
2011	78,989	40,000	38,989
Total Cash Flow	394,944	200,000	194,944
IPR&D Value	200,000	y makatid maa kati kuna atti kuna kees daa kati daa kati daa ka kati dhaa kati dhaa ka ta'aa ka mada ka mada k	

The current proposal can be enhanced by requiring the disclosure of management's cash flow and discount rate assumptions in connection with an IPR&D asset, when the asset is initially recognized during a business combination. This disclosure requirement will enhance the transparency of financial statements. In addition, it will enable investors to measure the potential effect of a successful IPR&D project on income. It will also make financial statements more comparable.

We appreciate the opportunity to comment on this exposure draft. Please contact Dr. Nathan S. Slavin, an associate professor of accounting at Hofstra University (Nathan.S.Slavin@hofstra.edul) or Abu R. Khan, a graduate student of accounting at Hofstra University (ryank@masconrestoration.com) if you would like us to clarify any of the points made in this letter.

Sincerely,

Dr. Nathan S. Slavin

Abu R. Khan