October 20, 2005

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference No. 1204-001: Business Combinations

Dear Director:

This letter represents the comments from the graduate and undergraduate accountancy students enrolled in the Advanced Accounting course of Professor Pam Smith at Northern Illinois University. We have learned about FASB Statement 141, Business Combinations, and in the process, we have also studied the Proposed Statement of Financial Accounting Standards: Business Combinations a Replacement of FASB Statement No. 141.

As students, we feel we represent the voice of future accounting professionals and we will enter the accounting profession under the new guidance provided by the Exposure Draft if it is adopted. We also feel we represent the future accounting students that will be required to learn and master the new guidance found in Exposure Draft.

As part of a class project, teams of students were randomly assigned different questions in the Exposure Draft and were required to provide a response to that question. The questions and responses are compiled in the following pages.

Respectfully submitted by the students who participated in this project and authored the responses to the questions.

Question 3 – In a business combination in which the acquirer holds less than 100 percent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognize 100 percent of the acquisition-date fair value of the acquiree, including 100 percent of the values of identifiable assets acquired, liabilities assumed, and goodwill, which would include the goodwill attributable to the noncontrolling interest? If not, what alternative do you propose and why?

After reviewing the FASB exposure document concerning business combinations, we agree with the position that even if the acquirer does not purchase 100% of the net identifiable assets attributable to the acquiree, the acquirer should recognize the acquiree at 100%. We also understand that the NCI will become a residual equity account, so a user of the financial statements will still be able to easily recognize that the acquirer does not own 100% (ED 1205-001). This requirement is consistent with recent FASB initiatives towards fair value reporting on financial statements.

The aim of financial statements is to provide a clear and concise picture of an entity so the user of the financial statements can make an informed decision on whether to invest in, lend credit to, engage in business with, or to form other relationships. In other words, the driving force behind financial information is that it is useful to the external decision maker. We believe that this proposed treatment for business combinations would ultimately provide better information to financial statement users to evaluate the total resources and obligations of the economic entity. Useful information is always both relevant and reliable.

We also believe that this proposed treatment would provide financial statement users with information that has a greater predictive value. Instead of accounting for a business combination using proportions of fair market value, the full fair market value of the economic resources and obligations is more relevant when evaluating past and predicting future performance.

To illustrate this point, let us assume that Acquiring Company, AC, acquires 80 percent of Target Company, TC. Even though AC theoretically owns only 80 percent of TC’s assets,
they have 100 percent control of how those assets are used. In this example, AC acquires and controls the entirety of the assets, not a portion of them.

Financial statements must also be reliable in order to be meaningful. If the full fair market value faithfully represents the economic resources and obligations available to the economic entity, then the users can rely on the constructs represented on the financial statements. This view is also consistent with non-proportional consolidation; the full value of the items is consolidated, so the full fair market value should also be represented.

The treatment of goodwill is an important change in this Proposal. Under current standards, the goodwill that is recognized by AC is the amount of the purchase price over the fair value of net identifiable assets acquired, which would be a proportional amount if less than 100 percent of the target company is acquired. Recognizing goodwill under the proposed statement requires determination of 100 percent of the goodwill, and a portion of that goodwill will be attributed to the noncontrolling interest based upon the procedures set forth in the Statement. The controlling interest’s portion of goodwill is the difference between the fair value of the TC and the AC’s share in the fair value of acquired identifiable net assets.

Some critics of this proposal have been quick to dismiss the objective that the FASB is trying to accomplish. One criticism of this proposal is that grossing up a 60% purchase price does not fairly represent a 100% acquisition purchase price. The answer to this criticism lies in the difference between the purchase method versus the newly proposed acquisition method. Accumulated cost, as used under the purchase method, would no longer be the basis to value the acquisition. FMV of the entity as a whole will be used to value the acquisition, and not cost. Therefore, since cost is not the basis for valuing the acquisition, the concern about extrapolation of cost is not relevant.
Question #4 — Do paragraphs A8-A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

Our understanding of paragraphs A8-A26, B23, and B60-B64, is that the measuring of the fair value of the acquiree is to be based on the fair value of the consideration except when: 1) there is no transfer of consideration on the acquisition date, 2) the transaction is not an exchange of equal values by willing parties, or 3) the total consideration is not more reliably measurable than the fair value of the acquiree. Under these circumstances, the fair value of the acquiree is to be valued based on a valuation technique such as the market approach or income approach. We believe there are certain issues, which the Exposure Draft does not address, and thus additional guidance needs to be provided.

Definition of Fair Value versus Implementation of Fair Value

In the FASB's *Fair Value Measurements Exposure Draft*, fair value is defined, "as the price at which an asset or liability could be exchanged in a current transaction between knowledgeable and unrelated willing parties." Members of American Accounting Association commented on this definition by stating that fair value "is relatively independent of the entity-specific use of the assets held or settlement of the liabilities owed." Through our reading of the *Business Combination Exposure Draft*, we find that there is a conceptual inconsistency between the definition of fair value in *Fair Value Measurement Exposure Draft* and its implementation in *Business Combination Exposure Draft*. In paragraphs A8-A26 of the exposure draft, an example is provided in which an acquirer values the fair value of the acquiree based on the stock price the acquirer transferred. The stock price (representing the purchase price), however, does not always equal the sum of the fair value of all the assets and liabilities, but instead, the entity-specific use

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1 Response to the FASB’s Exposure Draft on Fair Value Measurements, *Accounting Horizons*, Sep 2005, P191
of the assets or liabilities. Using the example found in paragraphs A8-A26, we believe that the FASB implies that the valuation of the consideration transferred may not necessarily be independent of the entity-specific use of the assets or liabilities. As a result, we believe that there is a conceptual inconsistency between the definition of fair value and its implementation in this statement.

Non-Arms Length Combinations

It is assumed that the transfers/combinations occur at arms length. For example, in paragraph 20, the Exposure Draft states, “Business combinations are usually arm’s-length exchange transactions in which knowledgeable, unrelated willing parties exchange equal value.” In some instances, business combinations may not be at arms length such as a business combination between an acquirer that may already have a significant influence in the acquiree.

SFAS 57 Related Party Disclosures provides guidance on related party transactions by illustrating specific examples of related party transactions such as this. However, the Business Combination Exposure Draft does not provide any specific guidance on the topic of when there should be question as to independence of the transactions. If the transaction is non-arms length because of circumstances other than related party issues, we feel paragraphs A9-A26, and 20 do not provide guidance on what criteria should be used to identify a non-arms length combination.

**Question 5**—Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer’s interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than acquisition date, when should they be measured, and why?

As proposed by the Exposure Draft, the acquisition-date is the date that the acquirer obtains control, which in most situations is the closing date. At this time, the consideration transferred in exchange for interest in the acquiree is valued. The consideration transferred not
only includes the assets transferred or equity issued, but also any contingent consideration as well as any noncontrolling equity investment in the acquiree that the acquirer possessed immediately prior to the acquisition date. The Exposure Draft provides guidance on the valuation of contingent consideration; however, there is no guidance provided for the valuation of non-controlling interest previously held.

To begin with, we agree with paragraph 20 of the Exposure Draft that suggests the consideration transferred represents the fair value of the interest acquired, assuming there is no case specific evidence to the contrary. We agree because most combinations are arms-length transactions. The consideration in an arms-length transaction represents fair value because it is the negotiated price between two parties. It is important to note that the purchase price is from an external, unrelated party willing to pay what it believes to be a fair value. The consideration transferred is verifiable in nature, which means that the purchase price can be proved through a series of calculations, and the method of estimation can be shown. Additionally, the purchase price is free from bias when the value is reached between neutral parties.

It is our opinion that including the contingent consideration as part of the consideration transferred will create more relevant information for users of the financial statements. By including contingent consideration as part of the price paid, financial statement users will be able to recognize what was actually given up or possibly could be given up to acquire the investment. With full disclosure of such contingencies, companies are unable to hide information from users, which can ultimately lead to investor confidence in the company and its financial reporting procedures. A contingent consideration is a probable future economic sacrifice and therefore a relevant obligation that needs to be disclosed. This information should be disclosed when the obligation is incurred, which is on the acquisition date when the consideration is transferred. It
should also be noted the reliability of the estimated value may be hindered somewhat, which is a trade off to the relevance of the information. Estimating the fair value of future events is not an easy task, especially without a crystal ball telling us the future. However, with the ever-increasing availability of information and dependability of various fair value techniques, the relevance gained by including contingent considerations as part of the consideration transferred outweighs any loss of reliability.

In turn, we agree the non-controlling interest owned immediately prior to acquisition should be included as part of the consideration transferred. Currently, under the purchase method, the valuation of additional shares purchased is recorded at fair market value (FMV), while any prior owned shares remain at historical cost. This leads to the investment account value being disproportionate to the acquiree's FMV due to valuation at different points in time. The new Exposure Draft proposes “the fair value of the consideration transferred by the acquirer includes the acquisition date fair value of any noncontrolling equity investment in the acquiree that the acquirer owned immediately before the acquisition date” (par. 56). This change will represent the investment account proportionate to the FMV of the acquiree at the acquisition date by revaluing the previous shares to FMV. As a result, financial users have more relevant information. The NCI re-measured value addresses timeliness by being current enough to influence decision-making. It provides instant feedback value to users by presenting the current value of the acquiree on balance sheet without making additional disclosures. It also supplies better predictive value since it allows users a better basis to determine the future performance.

However, within the Exposure Draft, the way in which the non-controlling interest should be measured to bring it to fair value is not explained. Currently the Board states in Appendix B “the acquirer re-measures any non controlling equity investment in an acquiree at its acquisition-
date fair value and recognizes any gain or loss in income of the period. The users of financial statements indicated that they did not have significant concerns...as long as the amount of the gain or loss is clearly disclosed" (par. B158). This statement leads to two possible methods of re-measurement for NCI: (1) NCI can be recalculated by multiplying the shares in NCI by the current market price of the stock at the acquisition date or (2) the consideration given to acquire the acquiree can be used to determine the value at 100%, which will then be used to determine the proportionate share of the NCI (extrapolation).

If the stock price is used to determine the NCI, this poses problems in determining the value of the NCI. The stock price of the acquiree is independent of the consideration transferred and reflects many factors, which may not be relevant to the FMV of the NCI. As new information about the company is released into the market (such as sales, research and development costs, and management) the stock price fluctuates to reflect those changes. If the market is aware of the consideration given to acquire the acquiree, the stock price is reflecting the investors’ opinion of the purchase. Therefore the stock price may not be a clear representation of the FMV of the NCI. Another negative of stock price valuation is that short-term spike in the acquiree’s stock price may result in inflated value. Furthermore, if the stock price is to be used, then what date should be used to determine the stock price? Is it the average between the agreement date and the closing date or should the value based on the closing date? It is our opinion that the proportionate share of the consideration transferred should be used as the best determinant for the value of the NCI because the value of the consideration is based on an agreement between a willing buyer and seller and represents a reliable and unbiased measurement.
Question 6 - Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

We agree that contingent payments should be measured and recognized at fair value at the date of acquisition. Contingent payments may be considered "bargaining chips" in a business combination. That is, additional money or other consideration will be paid to the seller if the combined and/or target company meets future performance goals. By offering contingent considerations, the acquiring company is encouraging and providing performance incentives to the acquiree. These contingent consideration payments are commonly offered and are an additional method to evaluate an acquiree. Recording contingent payments at current fair market value meets the four fundamental recognition criteria as stated in paragraph 875 in the proposed exposure draft. Contingent consideration adds to the value of the acquisition date FMV and therefore should be included in the acquisition date cost.

Including contingent considerations in the acquisition cost also allows for full disclosure of all aspects of the acquisition date transaction, not just the consideration exchanged on that date. Although contingent payments are not guaranteed to take place, recording them at fair market value as of the acquisition date is providing useful information to the financial statement user by disclosing that this aspect of the transaction exists. Full recognition and disclosure of the contingent consideration will make it difficult to take exchanges of value that may take place at a later date.

The Board has taken an interesting stance with ED 181. It seems to have brought the thinking of contingent consideration back around to where it started at the beginning of APB Opinion 16.

APB Opinion 16 Paragraph 15 states:
“Each party bargains on the basis of his assessment of the current status and future prospects of each constituent as a separate enterprise and as a contributor to the proposed combined enterprise.”

What this means is that the value of the “bargained transaction” should naturally include all costs and benefits resulting from the combination at a price that would be consistent with one that the marketplace would naturally bear. With this being said, the APB reverses this stance in Paragraph 79 of Opinion 16 and states that, “Contingent consideration should usually be recorded when the contingency is resolved and consideration is issued or becomes issuable.” This treatment, also upheld by FAS 141, does not record the bargained transaction at its full value at the time of combination. We believe the Board fixes this problem with this ED and now is consistent with FASB Concepts Statement No. 5.

We also support of the Board’s decision for the remeasurement of debt versus equity contingent consideration. Remeasurement of equity consideration should not occur because the entity should not record a gain or loss on its own equity instruments. Businesses would need to make the best measurement of fair market value of equity at the acquisition date. However, liabilities should be remeasured because gains and losses resulting from changes in the liability impact economic resources following the acquisition date.

Overall, we believe that subsequent revaluation of contingent considerations is consistent with the overriding philosophy in the proposed Exposure Draft, valuation of the acquisition at the acquisition date fair market value by including all contingent costs.
There were two points of view with respect to question 7 both responses are presented.

**Question 7 - Do you agree that the costs that the acquirer incurs in connection with a business combination are not assets and should be excluded from the measurement of the consideration transferred for the acquire? If not, why?**

**Questions 7 - Response A**

Question 7 states that all acquiring fees connected to the acquisition of a target company will no longer be capitalized but considered an expense. The Board also states that such costs must be disclosed separately because this will emphasize acquisition-related costs. However, this we believe this is inconsistent with the definition of an asset, which is a probable future economic benefit obtained or controlled by a particular entity, as a result of past transactions or events. We do not agree with the treatment of acquisition costs because of this definition.

FASB proposes to expense the acquisition related costs such as lawyers, investment bankers, accountants’ finder fees, etc. The current accounting practice is to capitalize these costs as part of the acquisition. The ED wants to expense these cost because the Board believes that the acquisition-related cost is not part of the fair value of a business combination, but instead it is a completely separate transaction that the purchaser makes in exchange for services rendered. The Board’s observation is that the acquirer does not pay for the services rendered at the date of acquisition but instead prior to it.

The Board’s reasoning for the treatment of these costs is inconsistent with the treatment of other costs to procure an asset, and place it in service. Currently, all direct costs to get an asset ready for use are capitalized as part of those asset costs. In a business acquisition, costs such as finder’s fee and fees paid to outside consultants for accounting, legal or evaluations are necessary cost for successful acquisitions. Fees for services rendered should be considered direct
cost because they would not have occurred if not for the acquisition and therefore are not recurring or indirect costs.

We believe that acquisition costs are unavoidable cost and are considered part of the acquisition by the buyer. The Board does not agree because the seller will not decrease the fair market value of its company due to the buyer spending more on acquisition related costs and the recovery of costs is separate issue. The Board concludes that buyer plans on recovering its diligence cost through post-acquisition operations. That is why they argue that direct cost should not be considered in the measurement of fair market value of the acquiree. We respectfully disagree and believe that those costs cannot be excluded from the investment, since those costs are incurred only to effect the transaction. Acquisition costs are in fact just that, cost incurred due to a successful business acquisition and are not incurred if not for that acquisition, therefore, it is an unavoidable cost. If a company can capitalize direct cost involving an asset acquisition then the company should be able to record business acquisition costs in a similar fashion.

Acquiring an asset or business will provide future economic benefit for the buyer.

**Question 7 - Response B**

We agree with FASB’s notion that acquisition costs should not be included in measuring the considerations transferred for the acquiree. To understand the logic in the treatment of the acquisition costs, it is essential to understand the FASB’s objective in issuing this proposal, to enhance the usefulness of financial statements by recognizing the *acquiree at fair market value* as of the acquisition date. The FASB believes, and we agree, that an organization’s balance sheet should reflect the economic entity represented by the fair market value of the entity as a whole and *not* the summation of cost paid or the fair market value of individual assets and liabilities.
Expensing the acquisition related costs should enhance the quality of the financial statements and will make them more useful for the users in following manner:

- **Understandable** – Listing the acquisition related costs paid to third parties separately will provide the readers with distinct categories on the financial statements (expenses vs. assets), thereby increasing the transparency of costs.

- **Representational faithfulness** – Capitalizing acquisition related costs is clouding the faithful representation of the acquisition date fair market value. If capitalized, the amount recorded for acquiree on financial statements doesn’t represent acquisition date fair value because the acquisition related costs inflate the fair value of the target company. Furthermore, including the acquisition related costs with the acquisition date fair value would result in different total fair value amounts between entities depending on how much each entity had in acquisition costs. For example, if company A and company B are both looking to purchase company C, then company A and company B would record different fair value amounts depending on how much each has in acquisition related costs.

- **Comparable** – Exclusion of acquisition related costs from the amount presented in balance sheets will help the reader evaluate and compare values among entities.

We also support the Board’s arguments and position in paragraph B97 that the seller of a business will not accept less than fair market value as consideration to accommodate buyer’s acquisition related costs.

Although we support the Board’s decision in not extending the scope of this Statement to acquisition of all assets group, we believe that it would be beneficial to the business community if the Board discloses their rationale behind coming to such a conclusion. We believe that doing
so would define the boundaries for the assets groups encompassed by fair value models and will provide better guidance to the community in application of the Proposed Statement.

Although we are strong advocates of recognizing assets and liabilities at fair value, and believe that reporting all assets and liabilities at fair value is the most transparent and faithfully represents the entity, in some instances doing so would be cost prohibitive. Therefore, we suggest that the recognition of the acquired entity at fair value be limited to business combination situations only, and should not be extended to include situations where the acquirer’s intention is not to obtain control of the entity. The basis for our suggestion is that acquiring an entity in a business combination for consolidated financial reporting and acquiring a general asset are conceptually different due to differences in the acquirer’s intent. Acquisition of an entity and acquisition of an asset also differ in nature. Assets can be reproduced and are replaceable, however, an entity is a combination of assets operating in unique business environments and are mostly irreplaceable. These differences between an entity and an asset can be used to develop and define different basis of recognition and reporting that represents the combined entity at fair value while maintaining the individual assets on accumulated costs basis.

Question 8—Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

A. Receivables (including loans) acquired in a business combination would be measured at fair value. Therefore, the acquirer would not recognize a separate valuation allowance for uncollectible amounts as of the acquisition date.

In part A of question 8 we disagree with the proposed format of reporting accounts receivable without the tandem allowance account. End users are quite capable of understanding
allowance for uncollectible and the information provided in the allowance permits management
to evaluate the historical activity of that account.

The exposure draft proposes that receivables acquired in a business combination be
measured at fair value. The draft would not allow the acquirer to recognize a separate valuation
allowance for uncollectible amounts as of the acquisition date. This concept sounds simple
enough; the receivable is netted by deducting the amount believed to be uncollectible post
acquisition. If the uncollectible amount is removed from the receivable as part of the acquisition
or if the allowance for uncollectible accounts is carried over, the net receivable is the same.
Even though the end result is the same, companies are forced to deduct that allowance amount
from the receivable and the estimate is no longer an estimate but in point a fact. By forcing
companies to net the receivable, the historical credit information on the customer base has been
destroyed. If the acquirer needed to evaluate specific customer credit histories and original
receivable balances, the data would not be easily available.

B. This Statement would amend FASB Statement No. 5, Accounting for Contingencies, to exclude
from its scope assets or liabilities arising from contingencies acquired or assumed in a
business combination. Assets and liabilities arising from contingencies that are acquired
or assumed as part of a business combination would be measured and recognized at fair
value at the acquisition date if the contingency meets the definition of an asset or a liability
in FASB Concepts Statement No. 6, Elements of Financial Statements, even if it does not
meet the recognition criteria in Statement 5. After initial recognition, contingencies would
be accounted for in accordance with applicable generally accepted accounting principles,
except for those that would be accounted for in accordance with Statement 5 if they were
acquired or incurred in an event other than a business combination. Those contingencies
would continue to be measured at fair value with changes in fair value recognized in
income in each reporting period.

Part B of question 8 relates to contingencies acquired as part of the business combination.
We agree that if the contingency meets the definition of a liability it should be recorded as
liability as of the acquisition date. The proposal forces management to value any contingent
liabilities of the acquiree at date of acquisition and embed the amount in the purchase price.

Requiring the valuation of all liabilities associated with the acquisition may compel a more
diligent review of the risks associated with the target company. In addition, full recognition and
measurement of contingent liabilities will provide information that has predictive value because
the user will be able to evaluate all economic obligations of the combined entity. Allocation of
the purchase price to contingent liabilities assumed will provide reliability, as the liabilities will
be faithfully represented as obligations.

C. Costs associated with restructuring or exit activities that do not meet the recognition criteria
in FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal
Activities, as of the acquisition date are not liabilities at the acquisition date. Therefore, the
acquirer would recognize those costs as expenses of the combined entity in the post
combination period in which they are incurred.

Part C states costs associated with restructuring or exit activities that do not meet the
recognition criteria in FASB Statement No. 146, Accounting for Costs Associated with Exit or
Disposal Activities, as of the acquisition date are not liabilities at the acquisition date. Therefore,
the acquirer would recognize those costs as expenses of the combined entity in the post
combination period in incurred.

We agree with the proposed change. Currently, under SFAS 146, business combinations
are specifically exempt from recognition of a liability for exit and restructuring costs. Under
proposed rules, all entities would be required to book a liability for the costs that meet the criteria
for a liability, at the acquisition date. Further costs that do not yet meet the definition of a
liability, at the acquisition date are treated as expenses in the period incurred.

Recognizing a liability under SFAS 146 is appropriate because it improves the qualitative
classics of accounting information. First, consistency is improved by booking
restructuring costs meeting the definition of a liability. Thus, all items that are actual liabilities
are treated as such. Second, the financial information of separate entities is more comparable.

All entities would recognize a liability for all qualifying restructuring costs at the acquisition date, providing a uniform basis for comparison.

D. *Particular research and development assets acquired in a business combination that previously were required to be written off in accordance with FASB Interpretation No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, would be recognized and measured at fair value.*

We feel that research and development should be accounted for as proposed in the exposure draft. We also feel that recording IPR&D as an asset is symmetrical to recording contingencies as liabilities in part B. Research and development should be recognized and measured at fair value at the time of the acquisition date. This is appropriate because in some circumstances businesses are acquiring other businesses for the sole purpose of being able to acquire the knowledge or intellect the business has when it comes to the development of new and existing products. In many cases the acquiree has a low net book value before considering research and development because FAS 2 does not recognize these costs as an asset. The ED proposes to add research and development into the calculation of the net book value. The recognition of the research and development as an asset would allocate the fair market value to the appropriate items rather than goodwill.

Decision usefulness will be improved by identifying research and development as an asset. It will provide information that has predictive value because the user will be able to evaluate all economic resources available and it also provides feedback value. Allocation of costs to research and development will provide reliability, as the asset values will faithfully represent the economic resources of the entity.
Question 10 - Is it appropriate for the acquirer to recognize in income any gain or loss on previously acquired noncontrolling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

Our concern about this question is illustrated in the following four cases:

Case 1: The acquirer has significant influence in the acquiree. Now, the acquirer obtains control of the acquiree.

The proposed FAS 141R would require remeasurement of the previously acquired net assets of the acquiree at the time the acquirer obtains controlling interest in the acquiree (a remeasurement event). This would result in a gain or loss on the previously acquired share in the acquiree. The gain or loss is the difference between the acquisition date acquirer’s share of fair value of the net assets of the acquiree and the fair value of the net assets of the acquiree at the time of acquisition of non-controlling interest. This case is illustrated with the help of the following example:

Company A acquires 49% equity shares of Company B on 1/1/2004 for $950,000. The fair value of the net assets of Company B at the time of this investment was $1,900,000. Now suppose Company A buys another 2% of the equity shares of Company B on 7/1/2005 for $50,000 and the market value of the net assets of Company B on 7/1/2005 is $2,000,000. This means that Company A acquires control (51% equity stock holding) of Company B on 7/1/2005.

| Acquirer’s share of the fair value of net assets of the acquiree on 1/1/2004 ($1,900,000*49%) | $931,000 |
| Acquirer’s pre-acquisition share of the fair value of net assets of the acquiree on 7/1/2005 ($2,000,000*49%) | $980,000 |
| Gain/(Loss) to be recognized in the income statement | $49,000 |
Case 2: The acquirer has insignificant influence in the acquiree. Now, it acquires significant influence.

The ED is silent as to how to deal with the change in the acquirer’s share of the fair value of the net assets of the acquiree acquired when significant influence is obtained. Therefore, we inferred that there would be no remeasurement of the acquirer’s share of the fair value of previously acquired net assets in the acquiree at the time the acquirer obtains significant influence. There would be no recognition of a gain or loss on the previously acquired share in the acquiree when the acquirer changes its method of accounting from cost method to equity method. This case is illustrated with the help of following example:

Company A acquires 10% equity shares of Company B on 1/1/2004 for $150,000. The fair value of the net assets of Company B at the time of this investment was $1,900,000. Now suppose Company A buys another 39% of the equity shares of Company B on 1/7/2005 for $800,000 and the market value of the net assets of Company B on 1/7/2005 is $2,000,000.

| Acquirer’s share of the fair value of net assets of the acquiree on 1/1/2004 ($1,900,000*10%) | $190,000 |
| Acquirer’s previous insignificant share of the fair value of net assets of the acquiree on 7/1/2004 ($2,000,000*10%) | $200,000 |
| Difference (This difference is not recognized) | $10,000 |

Case 3: The acquirer has significant influence in the acquiree. Now, it acquires more equity shares to increase its significant influence.

In this case too, the ED is silent as to how to deal with the change in the acquirer’s share of the fair value of the net assets of the acquiree acquired when the acquirer originally obtained significant influence in the acquiree at the time of increasing its significant influence in the acquiree. Thus, we inferred that there would be no remeasurement of the acquirer’s share of the fair value of previously acquired net assets in the acquiree at the time the acquirer increases its significant influence. There would be no recognition of a gain or loss on the previously acquired
share in the acquiree when the acquirer continues its equity method of accounting for business combination, though there is an increase in the significant influence exercised now. This case is illustrated with the help of following example:

Company A acquires 25% equity shares of Company B on 1/1/2004 for $325,000. The fair value of the net assets of Company B at the time of this investment was $1,900,000. Now suppose Company A buys another 15% of the equity shares of Company B on 1/7/2005 for $300,000 and the market value of the net assets of Company B on 1/7/2005 is $2,000,000.

| Acquirer's share of the fair value of net assets of the acquiree on 1/1/2004 ($1,900,000*25%) | $475,000 |
| Acquirer’s previous significant influence share of the fair value of net assets of the acquiree on 7/1/2004 ($2,000,000*25%) | $500,000 |
| Difference (This difference is not recognized) | $25,000 |

**Case 4: The acquirer has controlling interest in the acquiree. Now, it acquires more equity shares of the acquiree to increase its controlling interest.**

As with case 2 and case 3, the ED does not explicitly say how to deal with the change in the fair value of the net assets acquired by the acquirer where the acquirer increases its controlling interest in the acquiree. However, we inferred that there would be no remeasurement of the previously acquired net assets in the acquiree at the time the acquirer obtains increased control in the acquiree. Additionally, there would be no recognition of a gain or loss on the previously acquired control in the acquiree when the acquirer continues the acquisition method of accounting, though for an increased control in the acquiree. This case is illustrated with the help of following example:

Company A acquires 52% equity shares of Company B on 1/1/2004 for $10,000,000. The fair value of the net assets of Company B at the time of this investment was $1,900,000. Now suppose Company A buys another 8% of the equity shares of Company B on 1/7/2005 for $1,600,000 and the market value of the net assets of Company B on 1/7/2005 is $2,000,000.
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquirer’s share of the fair value of net assets of the acquiree on 1/1/2004</td>
<td>$988,000</td>
</tr>
<tr>
<td>Acquirer’s previous controlling share of the fair value of net assets of the acquiree on 7/1/2005</td>
<td>$1,040,000</td>
</tr>
<tr>
<td>Difference (This difference is not to be recognized)</td>
<td>$ 52,000</td>
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**Our View**

We believe that the difference presented in the cases can open the door to manipulations where companies will change the ownership of the investment in the investee to obtain the desired financial statement benefit. For example, in Case 1, by acquiring just another 2% of the equity interest in the acquiree, the acquirer is able to value its controlling interest in the acquiree at fair market value and recognize a gain or loss on the investment. While on the other hand, in Case 2, when a company increases holdings by 10%, it will not recognize a gain or loss on the investment. Thus, a difference of 2% holding changes the way the investment is accounted for only because a company obtains control.

Even though the significant influence increases in Case 3 or controlling interest of the acquirer increases in Case 4, there is no remeasurement of the previous significant influence equity share or controlling interest held by the acquirer. This means in Case 3, the 25% of the equity interest of the acquirer remains at cost (adjusted for equity method accounting) while the remaining 15% is at fair value. Similarly, in Case 4, the 52% of the equity interest of the acquirer remains at cost (adjusted for equity method accounting) while the 8% is at fair value.

We feel all changes in equity ownership are significant events; therefore we believe that designating only changes from non-control to control as the only “remeasurement event” would lead to non-comparability. We also believe that the “mixed attribute” that results from non-remeasurement diminishes the predictive value of such investments. The “mixed attribute” fails
to serve as a predictive tool about economic resources because part of the investment may be recorded at cost (adjusted for equity method accounting) and part may be recorded at current fair value.

Thus, we believe that a gain or loss should be recognized each time there is a change in the equity interest of the acquirer in the acquiree in order for the financial statements of the acquirer to be reliable and consistent. As we are moving more towards the fair value reporting, we believe that this treatment would provide more useful information to the financial statement user.
**Question 11---Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?**

With respect to the proposed treatment of the gain (net of positive goodwill) related to a bargain purchase, we agree. We feel that it is justified to consider the bargain purchase amount a gain, which will be included in net income. The acquisition of one company by another is the result of extensive negotiations between the buyer and seller. If the negotiated purchase price results in a bargain purchase price, that bargain purchase is an economic gain that should be reflected in the income statement. The fact that independent appraisers are involved in the determination of FMV of the acquiree increases the external verifiability (and therefore the reliability) of the bargain to external users. In addition, this treatment is a more faithful representation of the economic substance that has been achieved through the negotiation of the bargain purchase price.

We also considered what other alternatives are available to the treatment of this "credit" that results from a bargain purchase. We evaluated two alternatives and determined they were inferior to the treatment proposed. The first alternative is the current treatment, which is proportionate reduction of non-current assets relative to the fair market value. This treatment misrepresents the values of the non-current assets that have been valued by external sources by using an arbitrary allocation.

A second alternative would be to record the value as a liability. This alternative would be misleading because a bargain purchase price does not meet the definition of a liability in that it is not probable future economic sacrifice. A bargain purchase price is a measurable advantage that has the intention of leading to future advantages, such as increased profits.
The current proposal is the most reasonable option. By recognizing the gain and providing information about it in the footnotes the event is recognized in the period that it was incurred, allowing the user of the financial statements to better evaluate the merit of the acquisition.

On the subject of symmetry, the fact that a credit is recorded as a gain and a debit is recorded as an asset seems to go against the principle of conservatism. We feel that this is the lesser of two evils when studying the big picture of why the acquisition is taking place. If goodwill were considered a loss, the entity would be punished with lower earnings due to a decision that is meant to increase future economic benefits. While lacking symmetry, we feel as though recording a loss would also be a misrepresentation to the current earnings of the acquiring company.

Question 13 - Do you believe that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

We agree with the Board's position on retrospective restatement. Extending the adjustment window out to a year could increase the costs to companies and brings the possibility of greater earning volatility and confusion to past data. But the benefit of increase in decision useful information more than compensates for these possible problems.

The FASB is attempting to make the information presented to investors more relevant and reliable. With this the FASB is working in tandem with the IASB to converge international and US standards together. The ED proposes that the window for measuring the fair value of all of the assets and liabilities of the target be open as long as necessary, up to one year, for revaluation of those acquired items. In addition, the ED requires that all of the changes made during this adjustment period be reflected in the financial statements as of the acquisition date.
The primary argument against retroactive restatement is the potential cost to companies to restate and adjust the financial statements. However, there are important benefits to retroactive restatement. Retroactive adjustments enhance the predictive value of the economic resources and obligations of the entity. In addition the retroactive adjustments will provide more reliable information that is verifiable through subsequent events.

Retroactive adjustments of financial statements ensure comparability not only between years of operations, but also between different companies’ statements. If companies were to adjust prospectively for all the subsequent effects of the acquisition, the overall purchase price could be hidden. Retroactive adjustments increase the reliability and representational faithfulness of the information.