Ladies and Gentlemen:

Re: File Reference No. 1204-001

I appreciate the opportunity to express my views on the Board’s proposed Statement of Financial Accounting Standards Business Combinations – a replacement of FASB Statement No. 141 ("Exposure Draft I"). The Board has issued Exposure Draft I concurrently with its proposed Statement of Financial Accounting Standards Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries – a replacement of ARB No. 51 ("Exposure Draft II," collectively the “Exposure Drafts”). I have written a separate letter to the Board commenting on Exposure Draft II, and these two letters should be read in conjunction with one another.

The Board’s proposed approaches set forth in the Exposure Drafts represent radical changes from the current accounting models: from an historical cost model to a fair value model for business combinations and from a parent company model to an entity model for consolidations. For the reasons set forth below, I cannot support these changes, and I urge the Board not to move forward with these projects in their current form.

As both an investor and an auditor, I am a firm believer in the historical cost model of accounting. I believe that it is a common sense model that has withstood the test of time and is easy for common investors to understand. You buy an asset, you record that asset in your balance sheet at the price you paid for it. You sell an asset, you recognize a gain or loss. If an asset you hold becomes impaired, you recognize that loss when the impairment occurs. However, if the value of that asset increases, you do not recognize the gain until it is realized or realizable and earned.

It is the historical cost model that is still the basis for accounting for almost all assets and liabilities. In light of the fact that business combination and consolidation accounting is based on the concept of “seeing through” the shares acquired or held by the parent company and accounting for the individual assets and liabilities of the controlled subsidiary, it seems only logical that the accounting for business combinations should be consistent with the existing model for accounting for those individual assets and liabilities.
I also have certain misgivings about the fair value model of accounting. I have previously communicated those concerns in a letter to the Board dated September 7, 2004, and therefore I will not repeat them here.

Additionally, I am a believer in the parent company model for consolidations. My support for this model is based on the view that consolidated financial statements are prepared primarily for the benefit of investors and potential investors in the parent company. I believe that such individuals are interested in the earnings, assets, liabilities, and equity of the group that are attributable to the parent company's interest in its subsidiaries. After all, earnings or net assets attributable to the parent company's interest are what investors in the parent company would be entitled to receive if all of the earnings were dividended up the ownership chain or if all of the group entities were liquidated.

I also believe that a reporting entity should account for all of its assets and liabilities of a particular type in the same manner. I believe that a lack of consistency in accounting for a certain type of asset (e.g., accounts receivable) results in both a lack of transparency and confusion on the part of investors. So I am concerned about proposed requirements in Exposure Draft I that would lead to different accounting treatment for two otherwise identical assets (or liabilities) simply because one was acquired (or assumed) in a business combination and the other was not.

I am also deeply concerned about the Board's continued whittling away at the guidance in Statement 5, Accounting for Contingencies. The Board's proposed approach would allow companies to record contingent losses at their "fair value" even if those losses are not expected to be incurred and to record a gain through the income statement when the company's expectation subsequently is confirmed. In my opinion, this accounting is neither representationally faithful nor appropriate, and it is an open invitation for companies to recognize gains that do not exist.

Consistent with these views, I disagree with almost all of the proposed changes to current practice set forth in the Exposure Drafts. And while I applaud the efforts of the Financial Accounting Standards Board and the International Accounting Standards Board to work together to develop accounting standards that strive toward convergence, I cannot support those efforts at the expense of accepting what would be, in my opinion, lower quality US GAAP accounting standards.

I have included specific responses to most of the questions from Exposure Draft I in Appendix I, and I have also included some additional comments for the Board to consider in Appendix II.

Thank you for taking the time to consider my views. If you have questions or comments, do not hesitate to contact me.

Sincerely yours,

David B. Elsbree, Jr.

Appendices
Responses to Questions in Exposure Draft I

(Paragraph references in the appendices are to Exposure Draft I unless otherwise noted.)

Question 1 – Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

In my opinion, the objective that all business combinations be accounted for by applying the acquisition method and the definition of a business combination are not appropriate for accounting for all business combinations.

In paragraph B44, the Board states its conclusion that "virtually all business combinations are acquisitions" (emphasis added). However, the Board appears hesitant to state unequivocally that "all business combinations are acquisitions." If not all business combinations are acquisitions, logically it follows that some business combinations are not acquisitions, and it would seem entirely appropriate to account for such business combinations by some method other than the purchase or acquisition method.

I believe that some business combinations are, in substance, poolings and therefore should be accounted for as such. Although the rules in Opinion 16, Business Combinations, to distinguish pooling transactions from purchase transactions were clearly inadequate, these rules could have been improved to focus on distinguishing between transactions where a merger of equals has taken place versus those where one entity has obtained control of another entity.

I have no experience auditing mutual enterprises. However, based on the description of the Board's considerations in paragraphs B45-B47 as well as the views of one Board member in paragraph B212, it appears to me that at least some combinations of mutual enterprises likely are, in substance, poolings and therefore should be accounted for as such.

It is my view that in recent years, the Board has had a tendency to promulgate new standards that require the form of transactions to dictate the accounting, rather than the substance. In this case, the Board has reached a conclusion that all business combinations should be accounted for using one method. In my opinion, the substance of transactions should be the primary factor in determining the proper accounting, rather than the form. Some business combinations result in one entity obtaining control over another, and they should be accounted for one way. Other business combinations are essentially mergers of equals, and they should be accounted for in a different way. (Another notable example is the Board's conclusion that all derivative instruments should be accounted for using one method. In my view, some derivative transactions are hedging transactions, and they should be accounted for in one way. Others are speculative transactions, and they should be accounted for in a different way.)

With regards to the definition of a business combination, consistent with my view that some business combinations are, in substance, poolings of interests, I would recommend changing the definition to acknowledge that fact. For example, a business combination could be defined as "a transaction in which two or more independent (i.e., not under a common control structure) businesses are brought together under a common control structure."

I would also observe that the Board's definition of a business combination appears to be intended to include transactions in which an entity becomes the primary beneficiary of a variable interest entity as determined in accordance with Interpretation 46(R), Consolidation of Variable Interest
Entities. However, because the determination of the primary beneficiary of a variable interest entity is based on risks and rewards, rather than on control, it appears that some of these transactions would not be captured by the Board’s definition. To resolve this issue, I recommend that the Board reconsider Interpretation 46(R) in its entirety, as I have previously recommended in my letter to the Board dated December 1, 2003.

Question 2 – Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

It is not clear to me why the definition of a business in EITF 98-3, Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business, is considered to be “overly restrictive” (paragraph B36). It seems to me that, in order to be a business, an integrated set of assets and activities should both be self-sustaining and have outputs. The Board has not provided examples of cases where it believes that an integrated set of assets and activities constitutes a business but would fail the definition in EITF 98-3. I would gladly consider such examples if the Board would please provide them. For now, I consider the definition of a business in EITF 98-3 to be satisfactory.

I agree that the presumption that an asset group is a business if goodwill is present should be kept.

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 goodwill attributable to the noncontrolling interest? If not, what alternative do you propose and why?

Admittedly, the accounting for acquisitions of less than 100 percent of the equity interests of an entity is a tricky issue, and I do not have any easy solutions. Indeed, all possible methods of accounting for less-than-100-percent-owned subsidiaries are, in my view, less than satisfactory. In paragraphs B21 and B22, the Board has quoted various sources as being critical of the current mixed basis model (new basis for the proportion of assets and liabilities corresponding to the acquiring enterprise’s interest, carryover basis for the proportion attributable to the noncontrolling interest). While this approach clearly has its shortcomings, it may be the approach with the fewest of the evils.

I do not believe that recording 100 percent of the acquisition-date fair value of the acquiree, including the goodwill attributable to the noncontrolling interest, is the best approach. To do so, in my opinion, overstates the balance sheet of the consolidated enterprise. If the economic benefit that accrues to the parent company is some percentage less than 100 percent, showing those assets at 100 percent of their fair value can only be misleading to investors.

Perhaps renewed consideration should be given to the proportional method of consolidation in these situations. This approach would resolve two issues that are central to the Exposure Drafts. First, it resolves the issue of the measurement basis for the proportion of assets and liabilities attributable to the noncontrolling interest. Under the proportional method of consolidation, the parent company would include only its proportion of the assets and liabilities of a less-than-100-percent-owned subsidiary in the consolidated financial statements. Second, this approach also resolves the matter of the presentation of noncontrolling interests in the statement of financial position, one of the subjects of Exposure Draft II. Under this method, there would be no
noncontrolling interest recorded in the consolidated financial statements and therefore no debate as to where to present it in the statement of financial position. While this approach certainly has its own shortcomings, I do not believe that it should categorically be excluded from the debate.

Question 4 – Do paragraphs A8-A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

I disagree in principle with recording the acquiree at fair value, rather than at its historical cost. Accordingly, I believe that the guidance in paragraphs A8-A26 is unnecessary.

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 fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

I disagree with the proposed requirement to measure the consideration transferred on the acquisition date.

Rather, I believe that the existing guidance in EITF 99-12, Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination, is sufficient and is the most appropriate guidance. That guidance generally requires the acquirer to value its own shares transferred as consideration in a purchase business combination based on an average of the quoted market price a few days before and a few days after the transaction is agreed to and announced.

In my opinion, the EITF 99-12 approach is an appropriate approach. First, it incorporates into the valuation both parties’ perception of the value of the acquiree itself, because the exchange ratio in such a transaction is negotiated based on the stock price that is in effect at the time the transaction is agreed to. Therefore, valuation at the announcement date better reflects the intent of the parties than valuation at the acquisition date. Additionally, this approach has the benefit of incorporating the market’s valuation of the transaction by including the market price of the stock a couple of days after the announcement in the calculation.

The acquisition date market value of shares may not be relevant to the purchase accounting, because events unrelated to the business combination may have changed the values of the shares (up or down) in the intervening period. For example, there could be a significant devaluation in the overall market, as was the case after the events of September 11, 2001. Alternatively, there could be a significant announcement by a competitor, such as the launch of a new product or an earnings surprise, that influences the market price of the acquirer’s stock in either direction. Such events, if they were to occur, would have nothing to do with the valuation of the acquired enterprise as agreed to between the parties and therefore, in my view, should not be reflected in the accounting for the purchase price.

Question 6 – Is the [proposed] accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

I disagree with the Board’s proposed approach to accounting for contingent consideration. In my opinion, consistent with the historical cost model, the amount of consideration paid should dictate the amount at which the acquiree should be recorded in the consolidated financial statements.
Appendix I

Typically contingent consideration represents a compromise between parties who cannot agree on the purchase price (and therefore the fair value) of the acquiree. If the parties to the transaction cannot agree on the fair value, who are accountants and valuation experts to tell those entities what that fair value is?

In particular, I object to an approach that requires an entity to (1) record a liability for a contingent payment that is more likely than not to be made and (2) subsequently record a gain when its expectation is confirmed and it releases that liability. For example, let's assume that the acquirer believes that there is a 40 percent likelihood it will have to pay $1 million in a year and a 60 percent likelihood that it will not have to make any payment at all. Assuming a 10 percent discount rate, under the Board's proposed approach and consistent with the approach outlined in Concepts Statement 7, Using Cash Flow Information and Present Value in Accounting Measurements, the acquirer would record a liability of $360,000. A year later, when it is confirmed that no payment is required under the contingent consideration arrangement, the acquirer would record a gain of $360,000 because it did not have to make a payment it never expected to make in the first place. In my opinion, this is nonsensical accounting. Does the Board really believe that recording a gain in this set of circumstances is representationally faithful and improves financial reporting? Additionally, the ability to record subsequent gains by releasing purchase accounting contingencies through the income statement seems like an invitation for abuse.

The Board cites the definition of a liability in Concepts Statement 6, Elements of Financial Statements, in support of its view that the acquirer should record liabilities for both contingent consideration and acquired contingent liabilities. That definition states:

Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as the result of past transactions or events (emphasis added, second footnote reference omitted)

\[21\text{Probable is used with its usual general meaning, rather than in a specific technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, and refers to that which can reasonable be expected or believed on the basis of available evidence or logic but is neither certain nor proved (Webster's New World Dictionary of the American Language, 2d college ed. [New York Simon and Schuster 1982], p. 1132). Its inclusion in the definition is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain (pars. 44–48).}


The Board seems very focused on the obligation aspect of the definition of a liability; however, it seems to have overlooked the fact that this definition also includes an element of probability. This definition of a liability cannot be used to support the recording of a liability for contingent consideration in my example above, because regardless of whether one prefers Webster's or Oxford's definition of the word "probable," it cannot be said that a contingency that has a 40 percent likelihood of occurring is "probable." I assert that all rational adult native-English speakers would agree that events whose likelihood of occurring is 50 percent or less cannot be said to be "probable." Therefore, the Board's reference to the definition of a liability in Concepts Statement 6 simply does not support a practice of recording contingent liabilities (whether contingent consideration in a business combination or other contingencies) unless they have, at the very least, a greater than 50 percent likelihood of occurring.
I support an approach to accounting for contingent consideration that is consistent with the approach to accounting for contingencies required by Statement 5, with adjustments to any such liabilities being recorded as adjustments to the purchase price, rather than currently through earnings. This approach is consistent with the existing literature for contingencies and is also consistent with the substance of contingent consideration arrangements, viz. that they are adjustments to the purchase price of the acquiree.

I support a similar approach to accounting for other contingencies of the acquired business (see question 8), except that subsequent adjustments to amounts recorded in purchase accounting as a result of changes in facts and circumstances subsequent to the acquisition date should result in the recognition of a gain or loss in the income statement.

In paragraph B139, the Board states its view that “...fair value is the most relevant measurement attribute for contingencies and that the Statement 5 approach often fails to measure and recognize an existing asset or liability.” Although this is not the place to thoroughly debate the merits of Statement 5, I will observe here that I disagree with the Board’s view on this point. I support the model of accounting for contingencies in that Statement, and I agree with the views of one Board member that are expressed in paragraphs B205 through B208.

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 acquiree? If not, why?

In my opinion, the costs that the acquirer incurs in connection with a business combination are part of the historical cost of the acquiree and therefore should be included in the purchase accounting. To treat these costs otherwise would be inconsistent with generally accepted accounting principles for the acquisition of assets in general. Paragraph 6 of Statement 34, Capitalization of Interest Costs, states: “The historical cost of acquiring an asset includes the costs necessarily incurred to bring it to the condition and location necessary for its intended use” (footnote reference omitted).

The Board has acknowledged this inconsistency in paragraph B98 but has not set forth persuasive arguments as to why the acquisition of a business should be treated differently from the acquisitions of other assets. Instead, the states: “Board members agreed, however, that this Statement improves financial reporting by eliminating inconsistencies in accounting for acquisition-related costs...” I disagree that this change improves financial reporting. I would observe that the inconsistencies to which the Board refers could be more easily resolved in a manner that is consistent with the historical cost accounting model by allowing entities to capitalize certain internal costs incurred in connection with a business combination.

Question 8 – Do you believe that these proposed changes to the accounting for business combinations [to the method of measuring certain assets acquired and liabilities assumed] are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

I agree with the Board’s proposal to eliminate the requirement to measure and immediately write off in-process research and development assets (“IPR&D”) acquired in a business combination. I agree with the Board’s observation that this requirement results in information that is not representationally faithful (paragraph B142). However, I would observe that the general conclusion that IPR&D should not be capitalized does not seem to have changed, and therefore
my suggestion is that IPR&D not be measured and recognized as a separate asset, but rather that IPR&D be subsumed into goodwill, until such time as the IPR&D issue ultimately is resolved.

I generally disagree with the Board’s other proposed changes, because I believe that the guidance in Statement 141, *Business Combinations*, carried forward from Opinion 16, is generally appropriate.

In support of its proposed changes, the Board argues that these changes will bring greater consistency to financial reporting. For example, paragraph B104 states: “The Board noted that steps taken in this Statement toward consistent application of its recognition principle continue the process of improving the relevance and comparability of information provided about assets acquired and liabilities assumed in a business combination.” The Board also advances the consistency argument to support the approach of recording all acquisitions at 100 percent of fair value.

In both cases, it seems to me, the Board is sacrificing another, more important form of consistency, namely the consistency in accounting for similar assets and liabilities within the same set of financial statements. In my opinion, it is much more important to the transparency and understandability of financial statements that similar assets and similar liabilities be accounted for the same way consistently within a set of financial statements, regardless of how particular assets were acquired or liabilities were assumed. The Board’s proposed accounting in Exposure Draft I would result in a company’s accounting for receivables, inventory, contingencies, and certain other assets and liabilities differently within its own set of financial statements, depending on whether those assets were acquired or liabilities were assumed in a business combination or not. In my view, this situation should be avoided to the greatest extent possible.

Two examples worth noting are contingencies and inventory. With regard to inventory I would note that the Board proposes to eliminate the existing guidance in Statement 141 that finished goods inventory be recorded at estimated selling prices less costs of disposal and a reasonable profit allowance for the selling effort. It seems to me that the acquiring entity should be entitled to recognize a profit related to the selling effort when it sells finished goods it acquired in a business combination. Under the Board’s proposed requirement to record inventory obtained in a business combination at fair value, it seems likely that virtually no profit would be recognized by the acquiring entity. (If this is not what the Board intended, it should clarify that point.)

I believe that contingencies assumed in a business combination should be accounted for in a manner consistent with Statement 5. My arguments in support of this position are expressed above in my response to question 6 on contingent consideration.

With regard to exit costs, I believe that the existing guidance in EITF 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination*, that allows acquirers to include those costs in the purchase accounting if they meet certain criteria should be retained. I believe that most acquirers have a general estimate of the exit costs that may be incurred in connection with an acquisition on the acquisition date, based on their due diligence activities as well as negotiations with the seller. However, for various reasons, they cannot finalize these amounts or meet the criteria for recognizing a liability until some point in time after the acquisition takes place. It seems to me that these costs usually are considered by the acquirer at the time of the negotiations, are inextricably linked with the acquisition and, therefore, should be included in the purchase accounting. Not to include them likely results in an understatement of goodwill.
Question 9 – Do you believe that these exceptions to the fair value measurement principle [for the method of measuring certain assets acquired and liabilities assumed] are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

I agree with the exceptions to the fair value measurement principle in Exposure Draft I, and I support the other exceptions in Statement 141 that were carried forward from Opinion 16. As previously stated, I believe that, to the greatest extent possible, an entity should be required to apply the same accounting treatment to a particular type of asset or liability, regardless of how it was acquired.

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?

I agree with the Board that obtaining or losing control over a subsidiary is a “significant economic event.” However, I disagree that such an event warrants a new measurement basis as well as gain or loss recognition, and the Board has not set forth convincing arguments why this should be the case. In my opinion, that change warrants a change in the classification, but not the measurement, of that investment.

The Board may “[reject] the characterization that the resulting recognition of a gain or loss is from a purchase” (paragraph B159). However, there is no basis in the accounting literature for an entity to recognize a gain on previously acquired asset A when it subsequently purchases asset B.

On the other hand, I would note that if a loss is indicated on the previously acquired noncontrolling equity investment because the per-share purchase price of the additional shares to gain control of the entity is less than the per-share carrying value of that investment, it seems that some form of impairment test on that investment would be in order. I would support a requirement to perform one final impairment test on that investment prior to including it in the post-acquisition accounting in such circumstances, in accordance with the generally accepted accounting principles applicable to that investment. (In this regard, it would be helpful if the Board would provide additional guidance on determining when an impairment charge should be recorded on an equity-method investment.)

The simple fact is that the acquirer in this set of circumstances has not exchanged its shares that represent its equity-method investment. The acquirer does not, upon obtaining control, realize any gain on the shares held as an equity-method investment. The acquirer may be better able to run the business of the subsidiary the way it chooses because it has obtained control, but that fact should be reflected in the subsequent operating results of the consolidated enterprise. Given the fact that equity method accounting is essentially nothing more than “one-line consolidation,” it seems only logical to continue that same accounting (however presented differently) after control has been obtained without recording a one-time “blip” upon obtaining control.

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?

I disagree with this proposed approach, on the basis that this truly is recognition of a gain in connection with a purchase transaction, which I consider to be inappropriate. The basis in the acquiree should be recorded at historical cost. Once goodwill has been reduced to zero, I would record negative goodwill as a non-current liability that would be accreted to income in a manner
similar to the amortization of goodwill (see my comment in Appendix II on amortization of goodwill).

Question 12 – Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

I disagree with recognizing a loss on the acquired subsidiary immediately in connection with a purchase transaction, and therefore I do not consider this question relevant. Any such overpayment likely would be reflected as an impairment charge when the enterprise performs its annual goodwill impairment test, and I consider such accounting to be appropriate.

Question 13 – Do you agree 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?

I agree in principle with this proposal by the Board; however, I believe that such a requirement may be impracticable or otherwise so costly that it may not justify the practice. Increasingly tight SEC filing deadlines may also make this requirement overly burdensome on registrants. Additionally, such a requirement may lend itself to abuse if companies attempt to hide error corrections under the guise of recasting prior period financial statements in accordance with such a requirement.

Question 14 – Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

I support the Board’s inclusion of guidance for making this assessment. However, I do not believe that the application guidance in paragraphs A87 to A90 is sufficient to help me determine whether “[a] transaction or event [is] arranged primarily for the economic benefit of the acquirer or combined entity” (paragraph A88) in real-life fact patterns. I suggest that the Board consider field testing the application of this guidance to real-life fact patterns and include additional examples in a final Statement.

Question 15 – Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

As I have previously commented to the Board, I believe that “less is more” when it comes to disclosure requirements, because I believe that the longer the notes to the financial statement are, the less likely common investors are to actually read them. In my opinion, we accountants should focus on requiring those disclosures that are truly material, i.e., they would change the judgment of a reasonable reader of the financial statements, and we should eliminate disclosure requirements for information that might be “nice to have” for investors but is extraneous and not truly material.

I agree with the Board’s proposed requirement in paragraph 74(a) to disclose the incremental revenues and net income of the acquired company from the date of acquisition to the end of the fiscal year. This is information that I believe would potentially change my judgments about a company as an investor and that generally should not be costly for companies to track. It may also be material to a reader of the financial statements to include that information for the full fiscal year after the acquisition, especially if the acquisition in question occurred late in a fiscal year.
believe that the paragraph 74(a) disclosures render the pro forma disclosures in paragraph 74(b) superfluous, and I recommend eliminating the requirement for those disclosures.

I believe that the disclosures that are truly material are:

- The name of the acquired company and the strategic reason for the acquisition,
- The date of acquisition and the make-up of the purchase price,
- The disclosures required in paragraph 74(a), as noted above,
- The reportable segment(s) in which those results are included, and
- With regard to the purchase price allocation:
  - Whether or not it is complete,
  - If not, whether material adjustments are reasonably possible (as that term is defined in Statement 5), and
  - If material adjustments are reasonably possible, what their nature might be.

**Question 17** - Do you agree that any changes in acquirer's deferred tax benefits that become recognizable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

I believe that such deferred tax benefits are inextricably linked to the business combination and therefore should be accounted for as part of the business combination. I agree with those Board members who "...view the business combination as the triggering event for the recognition of the change" (paragraph B148).

**Question 19** - Do you find stating the principles in bold type helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

Yes, I do find that stating the principles in bold type is helpful. In particular, I think this practice emphasizes the interdependent nature of principles and rules. In my view, a high quality set of accounting standards is neither a "principles-based" nor a "rules-based" system, but rather a system that has broad general principles that are supported by rules that help preparers and auditors apply those principles.

I think it would be helpful if headings and principles were not both printed in bold type. Perhaps headings could be printed in bold italics, for example, to enable readers to more easily distinguish between the two.
Additional Comments

As I noted in my introductory comments, I urge the Board not to go through with these radical changes to the model for accounting for business combinations. This does not mean, however, that I believe that the current model for accounting for business combinations could not be improved. Below I have included some additional comments and questions for the Board to consider. I have divided these into two categories: (1) general comments and (2) specific comments on Exposure Draft I that are applicable only if the Board cannot be dissuaded from going forward with Exposure Draft I in its current form.

General Comments

- I commend the Board for including specific guidance on accounting for reverse acquisitions and accounting for stock options exchanged in a purchase business combination.

- Consistent with my view that the income statement should reflect "what you get out versus what you put in," I believe that goodwill should be amortized. I acknowledge that the question of the proper amortization period for goodwill is a difficult one. I also generally support the Board's goodwill impairment testing model in Statement 142, which I believe has been fairly successful. If goodwill amortization were reintroduced, I would support keeping the annual impairment testing guidance in place largely in its current form.

- I recommend that the Board provide additional guidance on the application of entity-specific vs. marketplace participant assumptions to determine the fair value of intangible assets acquired. For example, how should an acquirer value an acquired customer list if the acquirer already has all of those customers on its own customer list, and therefore that asset has no value to the acquirer?

- I also recommend that the Board provide additional guidance on the interaction of (1) the application guidance in paragraphs A45 to A49 on customer contracts and the related customer relationship assets and (2) the issues discussed (but not resolved) in EITF 03-9, Determination of the Useful Life of Renewable Intangible Assets under FASB Statement No. 142, with regard to renewable contracts and the useful lives and amortization methods for such assets. Additionally, it is not clear to me how one would go about determining the values of the contract asset and the relationship asset in the example in paragraph A49(a) (i.e., how to distinguish between the cash flows attributable to each) as well as how one would decide whether one or two assets exist in the example in paragraph A49(b).

- I applaud the Board's modification of the guidance in paragraphs 261-263 of Statement 109, Accounting for Income Taxes, on accounting for deferred taxes in connection with tax-deductible goodwill (paragraph B150). The existing guidance on this subject defies common sense.

- I believe that all new accounting standards that represent a change in accounting principle should be adopted as of the beginning of a fiscal year, and I support the Board's requirement of this approach in Exposure Drafts I and II. I believe that it is confusing to investors when new accounting standards are adopted in the middle of a fiscal year and/or in piecemeal fashion (e.g., Statement 141).

- As I have previously indicated in this letter, I believe that the accounting for an asset should not depend on how that asset has been acquired. Accordingly, in principle I support capitalizing internally developed intangible assets at their historical cost to the company. I also acknowledge that this approach would be difficult to implement in practice.
Specific Comments on Exposure Draft I

If the Board decides to issue a final Statement largely in the current form of Exposure Draft I, notwithstanding my comments, I suggest that it should provide additional guidance on the following topics:

- The Board should clarify whether its proposed changes to the measurement of assets acquired and liabilities assumed in a purchase business combination affects purchase price allocations underlying equity-method accounting under Opinion 18, *The Equity Method of Accounting for Investments in Common Stock*.
- The Board should provide guidance on how to classify gains and losses recognized upon obtaining or losing control of a subsidiary (e.g., operating vs. non-operating).
- The Board should clarify where an acquirer should record the offsetting credit (or debit, as the case may be) to record the subsidiary’s assets and liabilities at fair value when a company gains control over a subsidiary even though no consideration is exchanged (e.g., because a noncontrolling interest holder’s veto right has expired). Does the Board consider this situation to represent a “bargain purchase” to be accounted for in accordance with paragraphs 59-61?
- The Board should clarify its views on the accounting for tax contingencies acquired in a business combination, especially in light of the proposed new Interpretation on this subject.