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Technical Director – File Reference 1204-001
Financial Accounting Standards Board
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This letter is written to express the views of the majority of the members of the Appraisal Issues Task Force ("AITF") to the questions posed by the Financial Accounting Standards Board to the Proposed Statement of Financial Accounting Standards, Business Combinations, a replacement of FASB Statement No. 141.

The AITF was formed in July 2002, and is a voluntary group of business and intangible asset valuation specialists who wish to improve the practice of valuation for financial reporting purposes. It is designed to help establish and interpret existing and proposed rules as set forth by the FASB and the SEC. Further, it attempts to work with the FASB, SEC, and PCAOB to evaluate proposals and recommend methodology, assumptions, and approaches. With approximately 70 members, the AITF has held 14 meetings and convenes quarterly in either New York or Washington for proximity to either the FASB or SEC headquarters. The meetings are also attended by observers from the FASB, SEC, and PCAOB, who participate in the discussions.

As stated above, the views expressed in the following responses represent that of the majority of the AITF members. The views, however, were not unanimous, and some members dissented from the positions expressed.

Furthermore, as the AITF is comprised of valuation professionals, rather than certified public accountants, the responses reflect the valuation implications of the questions and not the propriety of the accounting treatment.
1. Objective, Definition and Scope - 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?

We agree with the objective, definition, and scope of business combinations as outlined in the exposure draft. We also agree that the measurement attribute is fair value as defined in SFAS 141 R. We would like to emphasize that we believe fair value measurements are determinable both for 100% acquisitions and for acquisitions of partial interests.

2. Definition of a Business - 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?

The proposed definition of a business helps clarify treatment of development stage companies. Nullifying EITF Issue No. 98-3 removes the problem of treating a development stage company as a set of assets, and not a business.

3. Measuring the Fair Value of the Acquiree - In a business combination in which the acquirer holds less than 100 percent of the equity interest 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?

We are receptive to recognition of 100% of the fair values of the assets, liabilities, and goodwill where the acquirer controls the business but holds less than 100% of the equity interest. We believe the consideration transferred is the best evidence of the fair value of the partial interest acquired, however we do not believe its extrapolation to the entity as a whole is always the best evidence of the fair value of 100% of the entity, due to issues relating to control, swing votes, etc. But we believe it is possible to determine the value of 100% of the fair values of the assets, liabilities and goodwill based on a partial acquisition, as long as the appropriate facts and circumstances, assumptions and methodologies are utilized in the determination of fair value for 100%.
4. Measuring the Fair Value of the Acquiree – Do paragraphs A8-A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

As long as the objective is the determination of the FV of 100% of the acquiree, and an appraiser can apply his judgment based on the facts and circumstances then A8-A26 should be sufficient.

However, when the acquirer is purchasing less than 100% of the acquiree, further clarification is requested. We are in agreement that the fair value of the consideration transferred is the best evidence of the fair value of the interest acquired, but not necessarily the best evidence of the fair value of the entity. For example, if an acquirer obtains 60% of a business for $60 million this does not mean that the FV of the total acquired business is $100 million. It could be higher, or lower, depending on the facts and circumstances which would include several variables, such as whether the partial interest represents control, minority or a swing vote, etc.

We recognize that no example can be all encompassing and that the facts and circumstances surrounding each transaction will be different and between transactions can vary widely. However, it would be helpful to provide an example that illustrates you cannot simply “gross-up” the consideration paid for a partial interest to 100%.

5. Measuring the Fair Value of the Acquiree – 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 the acquisition date, when should they be measured, and why?

The fair value of the assets acquired has historically been their acquisition-date fair value. Requiring the consideration transferred to also be measured at the acquisition date removes an existing inconsistency.

Therefore, we agree that the acquisition date, not the announcement date, is the best date for measurement of consideration.

6. Measuring the Fair Value of the Acquiree – Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

The AITF is a membership organization of valuation specialists. As such, we do not feel it is appropriate that we comment on questions that relate solely to accounting treatment. From a valuation perspective, we believe it is possible to estimate the value of contingent consideration, both at the acquisition date and after the acquisition date, subject to all the usual limitations of making value estimates based on assumptions made about future
events that may or may not prove true. Furthermore, we note that the responsibility for assumptions regarding future events rests with management of the acquiring entity, and while we believe the "valuation specialist" has a responsibility to perform reasonable "due diligence" on management's assumptions, it is beyond the scope of the valuation specialist's expertise to create assumptions regarding future events relative to the acquiree's future performance.

7. **Measuring the Fair Value of the Acquiree** - 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?

We agree that the costs an acquirer incurs in connection with a transaction are not "assets". This is consistent with the fair value of a publicly-traded security, which would be based on its trading price, but exclusive of transaction costs. However, additional guidance may be needed to distinguish these transaction costs from "soft costs" which are required to be capitalized when a manufacturing facility is built. Soft costs are typically included in the estimate of fair value of such a facility under a cost approach, as well as machinery and equipment which capitalizes installation and other transaction costs under a "value-in-use" premise.

8. **Measuring and Recognizing the Assets Acquired and the Liabilities Assumed** - 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, B) Contingencies, C) Restructuring Costs, D) IPR&D

(A) Receivables - The treatment is appropriate. Fair Value would be face less a reserve for uncollectible accounts.

(B) Contingencies - We agree that contingent assets and liabilities should be accounted for in connection to a business combination. However, members of the AITF have the following concerns related to the valuation of contingent assets and liabilities:

1. **Disclosure.** Disclosure in a company's financial filings should emphasize that the company's valuation of the contingent liability/asset is an *estimate* and that the actual future outcome of the contingency could vary significantly from the estimate as of the balance sheet date. If the estimate is based on a probability weighting of certain outcomes, it might be worthwhile to disclose the related probabilities. For example, if a company was involved in a lawsuit that it determined could result in a $100 million payment, but thought it had a 50% chance of winning the case and would therefore have to pay nothing, the company might value the contingency at $50 million. However, investors should be made aware that the outcome of the $50 million contingency may actually be much greater or much less than this estimate.
2. Availability of data. We are concerned that many companies and their legal counsel will be extremely reluctant to provide information (probabilities, estimated damages, etc.) related to the outcome of ongoing legal disputes. Additionally, in the absence of extensive cooperation on the part of a company and its counsel, little third-party information exists that will enable appraisers to properly analyze and value these contingencies. Professional appraisers do not possess the expertise to properly assess the likely outcome of an ongoing dispute without extensive input from counsel. If a company’s counsel is unwilling to share its assessment of outcomes and related probabilities, in an effort to protect the company’s legal strategy or some similar reason, appraisers will be in an untenable position. The contingencies must be valued, but appraisers will have little reliable data upon which to make such an estimate.

(C) - Restructuring Costs – No comment – we believe this is an accounting issue, not a valuation issue.

(D) - IPR&D – Research and development assets were previously recognized and measured at fair value. The accounting treatment under FASB Interpretation No. 4 was consistent with treatment accorded R&D expenditures in general.

The proposed capitalization of research and development assets will create a mixed accounting model, in that period expenditures for R&D both before and after the acquisition date will be expensed, but the fair value of R&D assets at the acquisition date will be capitalized.

We do not believe this treatment is appropriate.

9. Measuring and Recognizing the Assets Acquired and the Liabilities Assumed - Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

We agree these exceptions are appropriate. No further comment.

10. Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations – Is it appropriate for the acquirer to recognize in income any gain or loss on previously acquired no controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

We will not comment on the accounting treatment. However, we wish to reiterate that it is possible to determine the fair value of 100% of the entity from a partial acquisition, though it is not appropriate to simply do a pro-rata “gross-up.”
11. **Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations** – 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?  

12. **Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations** – 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?

We are in complete agreement with the premise of Paragraph 20 of the SFAS 141 Revised Exposure Draft, which states the following:

Business combinations are usually arm’s-length exchange transactions in which knowledgeable, unrelated willing parties exchange equal values. Therefore, in the absence of evidence to the contrary, the exchange price paid by the acquirer on the acquisition date is presumed to be the best evidence of the acquisition-date fair value of the acquirer’s interest in the acquiree.

We also agree with the statement in Paragraph 59 that bargain purchases are rare. In our experience, however, bargain purchases are rare not because there are few instances where the seller is acting under compulsion. They are rare because the seller typically has more access to relevant data than the buyer, and can command prices which are at but not below fair value.

Less rare are situations where the price paid exceeds fair value, for precisely the same reason: the seller has greater access to information, and commands a price at or above fair value.

Most members of the Appraisal Issues Task Force are confident that they can estimate the fair value of the interest in the acquiree with reasonable reliability, and conclude whether the acquisition date fair value of the consideration transferred constitutes a bargain purchase or an overpayment. However, the AITF members do not agree that a gain should be recorded on a bargain purchase, or a loss recorded on an overpayment, at the acquisition date unless conclusive evidence of one of the following conditions exist:

- In the case of a bargain purchase, compulsion on the part of the seller (for example, a forced liquidation or distress sale).

- In the case of an overpayment, compulsion on the part of the acquiror.

- Change in the fair value of the consideration transferred between the date the acquisition was agreed to and the closing date of the transaction.

We suggest that in those cases where the fair value of the identifiable assets acquired, less the fair value of the liabilities assumed, and recognized in accordance with the requirements of SFAS 141R, exceed the fair value of the acquisition date consideration transferred, the acquirer should first review the procedures used to measure the assets
acquired, the liabilities assumed, and the consideration transferred, and remeasure if necessary. If the fair value of the assets less the fair value of the liabilities still exceeds the fair value of the consideration, there should generally be a pro rata reduction of the fair value of the noncurrent assets until the excess is absorbed. Gain would be recognized only in those cases where compulsion on the part of the seller is supported by conclusive evidence, and/or the fair value of the consideration declined from the date negotiations concluded to the closing date.

Where the fair value of the consideration transferred exceeds the fair value of the identifiable assets acquired, less the fair value of the liabilities assumed, the excess should be recorded as Goodwill. A loss should be recognized only in those cases where compulsion on the part of the buyer is supported by conclusive evidence, and/or the fair value of the consideration increased from the date negotiations concluded to the closing date.

13. Measurement Period – 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?

No comment.

14. Assessing What is Part of the Exchange for the Acquiree – 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?

The guidance is sufficient.

15. Disclosures – 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?

We agree the disclosure objectives and minimum disclosure requirements are adequate, however see additional comments on disclosure in our response to Question 8 (b) re: contingent liabilities.

16. The IASB’s and the FASB’s Convergence Decisions – Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognized separately from goodwill? If not, why? Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristics: (a) the intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or
liability; (b) cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?

An intangible asset that is identifiable can be measured with sufficient reliability to be recognized separately from goodwill.

17. The IASB’s and the FASB’s Convergence Decisions – 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?

No comment.

18. The IASB’s and the FASB’s Convergence Decisions – Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

Conceptually, we believe that disclosure differences should be eliminated if possible. The respective Boards should continue to work to eliminate differences.

19. Style of This Exposure Draft – 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?

Use of the “bold type” to state the main principles are helpful.

Yours sincerely,

Gerald J. Mehm,
Chairman,
APPRAISAL ISSUES TASK FORCE