October 28, 2005

Dear Technical Director:

Wachovia Corporation is pleased to have the opportunity to comment to the Financial Accounting Standards Board (the Board) on the proposed Statement of Financial Accounting Standards, Business Combinations (the Proposed Statement). Wachovia is committed to providing a broad offering of financial services to customers and creating more value for shareholders, and in connection therewith, we continuously explore acquisition opportunities in a variety of areas to complement our core businesses. Accordingly, we are very focused on the Board’s proposal and strongly object to certain of the provisions for the reasons we outline below.

We agree with the Board’s efforts to improve financial reporting by requiring that an acquirer recognize an acquired business at its fair value. It is very consistent with the Board’s other initiatives around fair value accounting. However, we strongly disagree with several specific requirements. The primary requirement with which we are concerned is that an asset valuation allowance cannot be recognized in purchase accounting [Question 8]. This requirement results in two accounting methods for the same type of assets and will reduce industry comparability. We also disagree
with requiring that changes to preliminary fair values that occur during the measurement period be the basis for restating prior periods [Question 13]. This requirement will lead to confusion among investors and regulators and could undermine internal accounting controls. Further, we disagree with the requirement to expense transaction costs [Question 7]. We believe expensing these costs is inconsistent with other areas of generally accepted accounting principles and a buyer considers those costs as part of the acquisition price.

The following are our comments on certain of the specific questions in the Proposed Statement on which the Board requested feedback:

**Definition of a Business**

*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?*

**Response:** Based on the definition of a business in paragraph 3d of the Proposed Statement, we believe almost all acquisitions will qualify as a business because, in theory, an acquirer would only make an acquisition if it will provide, “a return to investors”, or “dividends, lower costs, or other economic benefits....” Appendix A also discusses the definition of a business noting a business has three elements: input, process and output, which we believe may result in a different answer from the definition in paragraph 3d since not all acquisitions will have all three elements.

For instance, if a firm acquires an individual insurance broker with a book of customers, by referring only to paragraph 3d, the definition of business is met because presumably an acquisition would only take place if revenue is expected to be greater than the cost so it will provide a return to the buyer. In contrast, using the definition in Appendix A, the insurance broker would be considered an input and commission income is considered an output. Defining process is less clear but in general, an
individual insurance broker does not have the processes or carrier relationships to be able to complete transactions individually, so it appears that an individual insurance broker would not meet the definition of a business using Appendix A. In order to clarify the concept the Board is trying to achieve using the broad definition in the Proposed Statement, we recommend the Board provide examples of situations that would not qualify as businesses.

**Measuring the Fair Value of the Acquiree**

*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?

*Response:* We agree with the concept to record 100 percent of the acquisition-date fair value of the acquired assets and liabilities but we disagree with recording 100 percent of goodwill. By its nature, goodwill is a residual amount and is not calculable as a separate asset. As a result, we believe it is inappropriate to gross up goodwill that relates to the noncontrolling interest solely due to acquisition of the controlling interest. We recommend the Board limit goodwill to the acquiree ownership percent for the excess of fair value of the acquiree over the net amount of the fair value of identifiable assets acquired and liabilities assumed.

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

*Response:* Currently, under EITF 99-12, Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination, for public entities, an acquirer uses the market price of securities over a short period of time around announcement date to estimate fair value. Paragraphs A9 – A11 of the Proposed Statement discuss measuring the fair value of the acquiree using the consideration transferred at acquisition. We recommend the Board clarify if the
"consideration transferred at acquisition" is the opening, closing or average market price of the securities transferred on the acquisition date or if the acquirer may use a short period of time around acquisition date to estimate fair value. Because of daily stock fluctuations that may be entirely unrelated to mergers and acquisitions, we believe it is most appropriate to use a short period of time around consummation date.

**Question 6—Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?**

**Response:** We disagree with the presumption in the Proposed Statement that fair value includes contingent consideration because we do not believe contingent consideration meets the recognition criteria of SFAS No. 5, *Accounting for Contingencies* (Statement 5), that is, probable and estimable, on the acquisition date. In negotiating a business combination, the seller and the buyer often have different views of fair value of the business and contingent consideration is used to bridge the gap between the parties. If contingent consideration is recorded up front, the acquirer will be forced to estimate it using different views on probability of occurrence that will be imprecise and will require changes at every assessment date. We believe it is more appropriate and accurate to record contingent consideration when the event meets the Statement 5 criteria. We recommend the Board change the accounting for contingent consideration in the Proposed Statement to that threshold.

However, if the Board chooses not to change the accounting for contingent consideration in the Proposed Statement to a Statement 5 threshold, and contingent consideration is recorded at the acquisition date, we are concerned with the ongoing accounting for contingent consideration whereby in certain circumstances it would be recorded as a liability. The Proposed Statement currently requires that a liability be recorded for the fair value of the contingency on the acquisition date and subsequent changes in fair value are recorded in earnings. It appears contradictory that in situations where an acquisition is not performing as expected, the contingent consideration liability declines, and income is recognized for the reversal of the
liability. We recommend the Board change the accounting in the Proposed Statement for the reversal of a contingent consideration liability from income to goodwill.

*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?*

*Response:* We strongly disagree that transaction costs incurred in connection with a business combination should be expensed because we believe transaction costs are an integral part of consummating a business combination. In addition, expensing transaction costs is inconsistent with several areas of generally accepted accounting principles where transaction costs are included in the cost basis of the item:

- Securities – commissions are included in the basis of securities
- Debt – debt issue costs are capitalized
- Real estate - commissions are included in the basis of the property
- Construction – pre-acquisition costs are capitalized into the balance of the property
- Equity – equity issue costs are offset against proceeds
- Loans – loan origination costs are deferred as part of the basis of the loan.

We recommend the Board include transaction costs as part of consideration transferred.

**Measuring and Recognizing the Assets Acquired and the Liabilities Assumed**

*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?*
Question 9—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?

Response: We agree with the concept in the Proposed Statement that it is appropriate to record acquisitions at fair value and we support the Board’s efforts in fair value accounting. As for the definition of fair value, based on our experience in business combinations, fair value may differ from one unrelated party to another because different parties have different uses of the assets. For instance, in the case of a financial institution that acquires another financial institution, if an acquirer branch and an acquiree branch are located in the same area, the acquirer may determine that it will close one of the locations and either sell the building to a buyer that is a financial institution (value as a branch) or is not a financial institution (value as retail space). In that scenario, fair value of the building is going to differ depending on the ultimate buyer. We understand the definition of fair value in the Proposed Statement will be updated using the definition in the statement on fair value measurements that is scheduled to be issued in late 2005. In the working document for the statement on fair value measurements, there appears to be a concept of a reference market or, “the market with the price that maximizes the amount that would be received for the asset, assuming the highest and best use of the asset from the perspective of marketplace participants.” As part of updating the Proposed Statement, we recommend the Board consider the concept of the intended use of the buyer as well.

We strongly disagree with the prohibition in the Proposed Statement against valuation allowance carryover, which significantly impacts the allowance for loan and lease losses for financial institutions. We are concerned that the differences in accounting for originated loans versus purchased loans will make it extremely difficult for investors and regulators to accurately compare institutions and that typical risk ratios like the allowance to loans ratio will no longer be meaningful. For originated loans, the current accounting model is to recognize losses that meet Statement 5 criteria, which recognizes probable losses; whereas for purchased loans, fair value is based on an expected loss concept or life of loan losses. These models yield different
results, which can be significant. In addition, as part of adoption of AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3), we have learned that many loan systems do not have the functionality needed to apply this accounting properly and banks will need to maintain these records manually, which is an inefficient process. We recommend the Board permit valuation allowance carryover, or alternatively, remove this provision in the Proposed Statement in light of future fair value accounting initiatives.

In addition, the Proposed Statement requires the acquirer to recognize contingent assets and liabilities even if they do not meet the recognition criteria of Statement 5. After the acquisition date, the contingent assets or liabilities would continue to be reported at fair value with changes in earnings. Based on this, it appears the threshold that determines accounting for contingent assets and liabilities is different for an acquired contingent asset or liability (not Statement 5) compared with the acquirer’s accounting for its contingent assets or liabilities (Statement 5). We also believe fair value of a contingent asset or liability could be different from a Statement 5 asset or liability because fair value generally assumes a return component or a price that a third party would require to assume the contingent asset or liability. As a result, because there will be different accounting models, we believe the acquirer would be forced to segregate acquired contingent assets or liabilities from the acquirer’s contingent assets and contingent liabilities, which defeats the purpose of most acquisitions to gain efficiencies. We recommend the Board include contingent assets and liabilities in the exceptions from fair value accounting in the Proposed Statement.

Also, the Proposed Statement requires valuation on the acquisition date instead of the announcement date. For many acquisitions, due to required regulatory approvals, the time period between an announcement date and acquisition date may be significant. In that amount of time, stock prices will likely fluctuate and, to reduce risk surrounding volatile market changes, an acquirer may want to enter into a hedge. Currently, paragraph 21c(5) of Statement 133, *Accounting for Derivative Instruments and Hedging Activities* disallows a hedged item to be a commitment to enter into a business combination. According to Appendix D of the Proposed Statement, there does not
appear to be any expected revisions or amendments to Statement 133. We would like the Board to allow hedge accounting for commitments to enter into a business combination. Absent hedge accounting, economic hedges of the business combination will be included in earnings, which does not reflect the economics of the transaction.

**Additional Guidance for Applying the Acquisition Method to Particular Types of Business Combinations**

*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?*

*Response:* We do not agree with the requirement to recognize in income any gain or loss on previously acquired noncontrolling equity investments on the date the acquirer obtains control because a transaction with a third party has not occurred for the noncontrolling equity investment that would trigger income recognition. We are also concerned this provision will result in income recognition for situations other than business combinations in which an acquiree obtains control. We recommend the Board change recognition in the Proposed Statement from income to goodwill.

**Measurement Period**

*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?*

*Response:* We agree with the concept that a measurement period is necessary because in most cases, it is extremely difficult to accurately value all assets or liabilities at the acquisition date. However, we do not agree that comparative information for prior periods should be adjusted for measurement period adjustments because we believe such adjustments imply that restatement is necessary which will confuse financial statement users. In addition, if the financial statements for prior periods are constantly adjusted for changes during a measurement period, the underlying accounting records, such as the general ledger, will not agree to the financial statements, which undermines internal
controls over financial reporting. We believe it is more appropriate to disclose changes in goodwill during the measurement period in the notes to the financial statements in a goodwill rollforward.

Disclosures

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?

Response: We strongly disagree with the requirement to separately disclose the amounts of revenue and net income of the acquiree from the acquisition date forward which are included in the consolidated income statement for the reporting period because after the consummation date, management manages the business as a whole. In most cases, the main driver of a business combination is to gain synergies and efficiencies as a combined business. It will be very difficult and highly inefficient to segregate the acquiree and to refrain from combining operations for some period of time in order to meet this disclosure requirement.

For instance, when we acquire other financial institutions, we begin combining entities by converting the acquiree to our policies and procedures, which may impact accounting for specific assets or liabilities that will be different from the acquiree’s prior reporting. After the acquisition date, we begin consolidating loan, securities and deposit systems and once those conversions occur, the data is no longer separable. We also consolidate certain office buildings and we may close branches that are in the same area so space is no longer separable. In addition, we begin a process to select leadership and employees from both entities so employees are no longer separable. We also evaluate risk in the combined assets and sell assets to the extent that it does not meet our credit or other requirements so assets are no longer separable. Liquidity management is also managed for the combined entity, not on a separate entity basis.
Because of these points, we believe the disclosure requirement is not manageable or meaningful and is inconsistent with the overall goal of many mergers and acquisitions.

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We would be pleased to address any questions you may have regarding the comments in this letter or to discuss our position in more detail, at your convenience. I can be reached at 704-383-6101, or by email at david.julian@wachovia.com.

Sincerely,

David M. Julian
Executive Vice President and Corporate Controller

cc: Robert P. Kelly, Senior Executive Vice President and Chief Financial Officer