Letter of Comment No: A82
File Reference: 1204-001

Technical Director – File References 1204-001, 1205-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Madam,

We strongly disagree with most of the guidance proposed in the Exposure Drafts, Business Combinations, a replacement of FASB Statement No. 141 and Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries, a replacement of ARB 51 (collectively, the ED). We believe that the existing accounting is more aligned with the underlying economics of transactions and therefore, results in more useful financial statements for investors. As a result, we believe that existing accounting principles for business combinations and consolidations do not require major changes.

We have never used anything other than a discounted cash flows analysis to evaluate and value a business combination transaction. This economic analysis, which incorporates buyer specific cash outflows and expected cash inflows from economic ownership, is the basis for the purchase price, determines the rate of return on economic investment, and is used for senior management, the Board of Directors, and if required, shareholder approval of the transaction. This robustly prepared analysis reflects negotiations with the seller, and the buyer’s best estimate of expected outcomes. Current accounting is consistent with the assumptions used in the valuation model. The marketplace participant notion of fair value and the exclusion of some of the cash outflows (i.e., acquisition fees and restructuring costs), as required in the ED, disconnects the accounting model from the economic model and results in financial statements that are not as useful. We believe that the fair value is established by the buyer and seller as a result of the business combination transaction and not as a result of a hypothetical transaction among marketplace participants. We have not addressed the reliability and verifiability issues that arise with the use of this hypothetical notion. Further, we are troubled that none of the questions in the notice to recipients addressed this fundamental change to the marketplace participant concept, and that the marketplace participant notion of fair value is being addressed separately in the Board’s fair value project.

The economic unit concept introduced in the ED further obfuscates the understandability and therefore, the usefulness of financial statements. Investors use financial statements to predict the rate of return on their investments in the parent company. To reflect more than is economically owned by the parent company in the financial statements results in confusion, at a minimum. We are not aware of any investor need for such a dramatic change to current practice.
ISSUES FROM NOTICE TO RECIPIENTS ON BUSINESS COMBINATIONS, A REPLACEMENT OF FASB STATEMENT NO. 141

Objective, Definition, and Scope

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?

We agree with the definition of a business combination. However, we question many of the fundamental concepts underlying the ED, such as marketplace participant fair value and measurement of 100% of the acquiree in a business combination in which the acquirer holds less than 100%. Therefore, it is hard to contemplate the operational issues that may arise with such sweeping changes applied so broadly, especially to transactions not involving any consideration or any action by the acquirer without adequately evaluating the proposed requirements with actual transactions.

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?

As noted in our cover letter, we believe that a buyer’s intentions for the acquirer are paramount in valuing the assets acquired, and therefore, we object to the capability of willing-hypothetical-buyer criteria in paragraphs A3 and A6. In addition because the guidance in paragraph A2 is fundamental to the definition, the Board may want to place some of the definitional fundamentals in the body of the statement.

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?

We believe financial statements should reflect what an entity owns, not what others own.

Question 4—Do paragraphs A8-A26 provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?
We strongly object to the willing-hypothetic-buyer (marketplace participant) guidance. We believe that the fair value should be measured with buyer-specific criteria, as this is consistent with how the buyer determines the cash outflows it is willing to pay for the acquiree. Measuring fair value based on buyer-specific intended use will result in a value that is consistent with the underlying economics. We find this is particularly relevant to companies with global brands. An acquirer’s intended use of an acquired brand is instrumental in determining what it will pay for the brand, and therefore in determining the brand’s value. An acquirer’s intended use may differ significantly from a marketplace participant’s intended use.

**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 the acquisition date, when should they be measured, and why?

We believe the acquisition-date fair value of the consideration transferred in exchange for the acquirer’s interest in the acquiree is the best evidence of the fair value of that interest.

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

No, we believe that contingent consideration is negotiated as a result of an “agreement to disagree” and should be measured and recognized only when the conditions requiring payment have been met. The proposed requirement to measure the fair value of an amount that the buyer is not willing to pay unless certain conditions, which it does not believe are probable of occurring, are met, is not reflective of the underlying economics. We believe that measuring contingent assets and liabilities at fair value after acquisition date, with any changes in fair value recognized in income in each reporting period, distorts the operating results for those periods.

**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?

As noted in our cover letter, we believe that the total cash outflows related to the business combination are part of the buyer’s total purchase price and should be included in the measurement of consideration paid. This is consistent with how the return on investment would be measured for purposes of approving the business combination transaction and evaluating the return subsequent to acquisition. Capitalizing all the costs incurred in connection with a business combination is also consistent with the treatment of costs incurred to ready a fixed asset for use.

**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?
a. Receivables (including loans) acquired in a business combination would be measured at fair value.

While we agree that the fair value of the receivables should be the basis of measurement, the practicality of this requirement must be considered. Receivable balances arise from thousands of transactions recorded in sales/billing systems based on original invoice amounts. Any necessary allowances or reserves are recorded subsequently in separate ledger accounts. Adjusting the individual account records to fair value upon acquisition appears to be undue refinement of an estimate. We ask that the Board permit the adjustment to fair value to be recognized as a valuation account for practical reasons.

b. Assets and liabilities arising from contingencies that are acquired or assumed as part of a business combination.

As noted above, we believe that assets and liabilities arising from contingencies should be measured and recognized only when the conditions requiring the receipt or payment have been met. The economic evaluation of the return on investment will reflect any receipt or payment in this manner.

c. Costs associated with restructuring or exit activities.

As noted above, we believe that the consideration paid should reflect the total cash outflows based on buyer specific intentions of inflows resulting from the business combination transaction. Accordingly, if the buyer's cash inflows are dependent on certain restructuring or exiting activities, those outflows should be part of the total economic cost of the business combination transaction.

d. Particular research and development assets acquired in a business combination.

If the in process research and development is expected to generate cash inflows, then our buyer specific model could result in value assigned to such assets.

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?

We agree with the exceptions to the fair value measurement principles for deferred taxes, assets held for sale, and employee benefits. However, as noted throughout, we believe that the measurement should be buyer specific which would result in different measurements than the ED.

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?
No, we do not believe that a gain or loss should be recognized on previously acquired noncontrolling equity investments as a result of obtaining control of the acquiree. The proposed treatment results in recognizing amounts that have not been realized, which is not allowed under existing revenue and gain recognition rules. To the extent that any amounts were paid to acquire control, such consideration would be measured and recognized in accordance with buyer specific valuation methodology. We believe that application of the current accounting model is appropriate and has not resulted in significant practice issues.

In addition, as noted above, we believe that recognizing holding gains and losses in earnings is distortive.

**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?

Since we believe that fair value is established by the consideration exchanged, we believe that a situation in which the consideration is less than the fair value is a very unlikely hypothetical. In the unlikely event of a bargain purchase, we do not believe that income should be recognized.

**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?

We agree with the Board’s conclusion that no loss should be recognized.

**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?

No, we do not agree that comparative information for prior periods should be adjusted for the effects of measurement period adjustments. To adjust prior period financial statements would be operationally burdensome and would impact the credibility of reported results. We believe that adjustments to provisional values should be recognized when identified in current period results. Disclosures in the measurement period should indicate that amounts are based on a provisional allocation.

**Assessing What Is Part of the Exchange for the Acquiree**

**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?

We believe that the guidance provided in paragraphs A89-A93 needs clarification. Foremost, we do not agree with recognizing a gain or loss on the effective settlement of pre-existing relationships. In our experience, the transactions are inextricably linked and the settlement would
not occur without the successful completion of the business combination transaction. We concur with the Board’s guidance on compensation for future services.

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?

No. We disagree with many of the required disclosures because we disagree with much of the ED. Additionally, we believe that the cost benefit of the requirement to provide the required disclosures in aggregate for individually immaterial business combinations that are material collectively should be carefully studied. Lastly, we believe that some of the disclosures in paragraph 79 (goodwill disclosures for a business combination after the balance sheet date but before the financial statements are issued and the reason why information is not yet available), should also be studied by working groups as those requirements generally have practicality issues.

The IASB’s and the FASB’s Convergence Decisions

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?

No, we believe that changes in an acquirer’s deferred tax benefits that become recognizable because of a business combination are part of the fair value of the acquiree. Changes in the acquirer’s deferred tax benefits affect future cash flows and should be recognized as part of the purchase price.

In addition, we recommend that in conjunction with the Board’s consideration of the proposal to continue the deferred tax exception, they also reconsider an amendment to FAS 109 to allow indefinite lived intangibles to receive the same deferred tax exemption given to goodwill (i.e., do not require the recognition of deferred taxes related to nondeductible intangibles that are expected to be held indefinitely). If an indefinite lived intangible asset were to change to a definite live, the deferred tax could be recorded at that time. Recognition of deferred taxes on indefinite lived intangibles results in incremental goodwill and a balance sheet gross up in the financial statements which does not reflect the underlying economics of the transaction. Further, it does not seem appropriate to recognize deferred taxes related to indefinite lived intangibles when the taxes will be realized only in the unlikely event that the business is sold.

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 we find the bold type helpful.
November 29, 2005
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The sweeping impact of these proposed changes must be thoroughly evaluated by companies and users. There is not sufficient time in 2006 for Board deliberations, recommended field visits, redrafting and evaluation of the final standard by preparers. We urge the Board to delay the effective date.

Our comments to the specific questions included in the ED are included in Attachments I and II. We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that you may have. Please do not hesitate to contact me at (914) 253-3406.

Sincerely,

Peter Bridgman
Senior Vice President and Controller

cc:
Indra K. Nooyi, President and Chief Financial Officer
Marie T. Gallagher, Vice President & Assistant Controller