

From: [Ron DiMattia](#)
To: [Director - FASB](#)
Subject: File Reference No. 2011-190 - Technical Corrections
Date: Friday, November 18, 2011 3:34:46 PM

I appreciate the opportunity to comment on Proposed Accounting Standards Update, Technical Corrections, File Reference Number 2011-190.

While I appreciate the FASB's efforts to make technical corrections, I believe we are overlooking a much more serious and pressing issue. I noted that some of the corrections relate to Fair Value measurements, which are causing quite some difficulty for financial statement preparers and for users of those statements. In fact, it would be fair to say that certain elements of the FASB's Fair Value measurements are contributing to a loss of confidence in US financial reporting. It does not matter how many technical corrections we make to the standards when we are working with essentially unsound financial reporting concepts. The two most glaring examples are fair value of liabilities and bargain purchase gain.

Fair Value of Liabilities: I have written on this subject a number of times in previous comment letters to the FASB. Instead of reiterating my prior comments, I will summarize them briefly. Re-stating liabilities to fair value poses a number of problems, including that it conflicts with the concept of going concern and with long-standing legal precedent. Recent press reports make it clear that reporting liabilities at fair value is not even a "remotely accepted" accounting principle, let alone "generally accepted." A summary of recent quotes follows:

"Barclays' finance director has called for an overhaul of "opaque and complex" accounting rules that artificially boosted the profits of big European and US banks by billions of pounds in the third quarter of this year. In a letter published in today's Financial Times, Chris Lucas said the requirement for banks to adjust their figures to reflect the market value of their own debt was widely believed to distort their actual profits. 'It makes results difficult to explain to investors and is unhelpful for an industry that wants to rebuild confidence through transparency in financial reporting,' he wrote." ("Barclays Calls for Clarity on Fair Value Debt," [Financial Times](#) online service, November 14, 2011)

"Try this on your credit card company: your creditworthiness has weakened, so you write down the value of what you owe them to reflect the greater risk that you will not pay it all back and credit the difference to your personal income. This is exactly what accounting allows... This is wrong. 'Fair valuing' of their own debt and other credit instruments produces fantasy profits that will not be realized. Why? Because, in theory at least, banks can buy back that debt for less – regardless of the fact that their weaker position makes it far less likely that they would..." ("Fairlyland Value Accounting," [Financial Times](#) online service, October 23, 2011)

"...J.P. Morgan said Thursday the adjustment raised its third-quarter earnings by \$1.9 billion before taxes. The gain stems, counter-intuitively, from an accounting rule under which banks record profits when the market value of their debt declines...Moody's Investors Service routinely strips out such gains and losses when evaluating a bank's earnings, said Mark LaMonte, chief credit officer for Moody's financial-institutions group. 'It's an accounting standard that we find particularly

unhelpful,' he said. The FASB 'acknowledges that this reporting method is controversial,' said FASB spokesman Robert W. Stewart." ("Accounting Quirk Juices Net," The Wall Street Journal online edition, October 13, 2011)

I could go on with more quotes, but the point is clear. The words "generally accepted accounting principles" have meaning to financial professionals. Accounting rules for the fair value measurement of liabilities are neither "generally accepted," nor consistent with the principles of objectivity and conservatism.

Bargain Purchase Gain: I was troubled reading "Secrets of the Bargain Basement" (CFO Magazine, May, 2011, page 21). The article describes the work of a researcher that identified "71 bargain purchase transactions that took place in 2009." The number seems high because the implication in accounting pronouncements is that the realization of a bargain purchase gain should not be common, and should only be recognized after checking and re-checking the analyses. Additionally, over the years business professionals have been told by researchers that most (if not nearly all) acquisitions destroy shareholder value because the buyer tends to overpay. One researcher went so far as to say that a primary motivation behind acquisitions is the ego of the acquiring CEO.

Is the reason that there have been so many bargain purchases due to management teams suddenly becoming much better at acquisitions? Apparently not, because the reasons given in the article seem to indicate that sellers have become less careful about maximizing value. Twenty-four of the bargain purchase transactions studied, "involved FDIC assisted acquisitions of distressed commercial banks." Certainly not good news for taxpayers, but even worse for the shareholders. Other reasons cited are, "the absence of competitive bidding," and "the target's desire for a quick exit from a noncore business." These explanations speak directly to the fiduciary responsibility of those entrusted with the care of the companies being sold. I'm just guessing, but I bet if you asked the FDIC and the Boards of Directors of the companies being sold, they will tell you absolutely that they received fair value, and that they followed proper procedures (fair and active marketing process) in selling the companies.

So how could 71 transactions be recorded as bargain purchases in just one year; especially given corporate America's presumably poor track record with acquisitions? It all has to do with the futility of measuring the value of acquisitions shortly after a transaction closes. Acquisitions are, by their very nature, a long-term proposition and their relative value is perceptual. The FASB acknowledged this fact when it decided not to consider over-payments in SFAS 141R:

Overpayments

B382. The Boards considered whether this Statement should include special provisions to account for a business combination in which a buyer overpays for its interest in the acquiree. The Boards acknowledged that overpayments are possible and, in concept, an overpayment should lead to the acquirer's recognition of an expense (or loss) in the period of the acquisition. However, the Boards believe that in practice any overpayment is unlikely to be detectable or known at the acquisition date. That is, the Boards are not aware of instances in which a buyer knowingly overpays or is compelled to overpay a seller to acquire a business. Even if an acquirer thinks it might have overpaid in some

sense, the amount of overpayment would be difficult, if not impossible, to quantify. Thus, the Boards concluded that in practice it is not possible to identify and reliably measure an overpayment at the acquisition date. Accounting for overpayments is best addressed through subsequent impairment testing when evidence of a potential overpayment first arises.

Buyers and sellers will hold different views of value – for that matter, investors will too. That’s why we have stock markets. If investors perceive value in management’s activities then they buy shares; if not then they sell shares. Additionally, as many large consulting firms will tell you, the single most important activity in any acquisition is the post-transaction integration process – the day-to-day and year-to-year work by every employee to make the deal a success. It is not realistic to expect that management teams can credibly measure the amount by which the fair value of the assets acquired and liabilities assumed (both explicit and implicit) exceed the purchase price paid within a few months of the transaction closing. The real proof of an acquisition’s value comes only after a lengthy period of time has passed, and management’s plans are proven to be wise or misguided.

In summary, can we skip making technical corrections and just get to the heart of the matter? Fair Value for financial reporting is deeply flawed. Fair value for liabilities and bargain purchase gain are just two examples of fair value accounting concepts that should be removed from our literature. Their measurement is highly subjective, conflicts with other elements of accounting standards, is not generally accepted and will likely lead to significant reporting problems. By continually amending the existing literature we are getting drawn into a situation that is compartmentalized – no one can really tell where the standards are going because we keep focusing on only small parts of it. We need to take a step back and look at the entire picture.

Thank you for considering my comments.

Sincerely,

Ronald D. DiMattia
President
Corporate Value Partners, Inc.
1340 Depot Street, Suite 102
Rocky River, Ohio 44116
440-333-1910