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Comment Letter on the FASB's June 1997 Special Report, Issues Associated with the FASB Project on Business Combinations (the Special Report)

American Institute of Certified Public Accountants. Business Combinations Task Force

SKCL #32600

October 9, 1997

What: AcSEC's Comment letters
Why: FOR YOUR INFORMATION

To the Accounting Standards Executive Committee:

File Reference No. 174-F and File 2285

Please find attached AcSEC's final comment letters to the FASB on it's June 1997 documents, *Employers' Disclosures about Pensions and Other Postretirement Benefits* (ED) and Special Report, Issues Associated with the FASB Project on *Business Combinations*.

Sincerely,

Liz Fender

Elizabeth Fender, CPA
Director
Accounting Standards

Enclosure

EF:sm

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September 26, 1997

Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Lucas:

The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants and its Business Combinations Task Force appreciate the opportunity to comment on the FASB's June 1997 Special Report, *Issues Associated with the FASB Project on Business Combinations* (the Special Report).

Need for the Project

AcSEC believes that current accounting standards for business combinations and related intangibles are the result initially of compromise and subsequently of ever more complex interpretation. The current standards, including APB Opinion No. 16, *Business Combinations*, APB Opinion No. 17, *Intangible Assets*, and related AICPA Interpretations, FASB Interpretations, FASB Technical Bulletin, consensus positions of the FASB's Emerging Issues Task Force, and SEC Staff Accounting Bulletins, represent a complex patchwork approach that results in financial reporting that often emphasizes the form over the economic substance of transactions. In AcSEC's view, these current standards clearly could be improved.

As the board begins this project, it should be mindful of the findings included in the *Comprehensive Report of the Special Committee on Financial Reporting* (the Jenkins Committee Report), which reflects user views. The Jenkins Committee Report states, in relevant part:

> While it is true that some users prefer the purchase method and some prefer the pooling method, most also agree that the existence of the two methods is not a significant impediment to the users' analysis of financial statements...

> Rather than a project to reconsider accounting for business combinations, users would prefer a project to strengthen disclosures about business combinations. For example, many believe there is not enough disclosures under purchase accounting about how assets are written up or down and about how liabilities are created at acquisition and how those liabilities are settled in later periods. They are concerned, for example, that some companies are overly conservative in measuring liabilities at the date of acquisition, resulting in inflated reporting in later periods.

In light of user views that suggest that they do not have an immediate need for revised accounting standards for business combinations, AcSEC believes that the Board can take the time needed to fully and comprehensively deliberate the issues surrounding business combinations and relevant related issues. To that end, AcSEC believes that the Board should address the issues in the project simultaneous with addressing the inter-related issues pertaining to new basis accounting, as discussed below.

Addressing New Basis Accounting

We acknowledge the arguments for reconsidering the conceptual underpinnings of the pooling of interests method and the practice issues associated with the application of the purchase method, such as accounting for goodwill, research and development costs, and other purchased intangibles. However, we believe an equally fundamental issue that should be addressed by the Board is determining circumstances in which transactions should be reported using new basis accounting. We believe a significant number of practice problems emanate from the fundamental issue of new basis accounting. Recapitalizations, joint ventures, SAB 48 and 97 transactions, and nonmonetary transactions all incorporate elements of the new basis issue. We believe that resolving this issue should be a critical component in arriving at a consistent accounting model for business combinations.

In developing criteria pertaining to the circumstances in which new basis accounting should be used, the Board should further develop guidance for determining both the *reporting entity* and circumstances in which there has been a *change in control*. In addressing the reporting entity, the Board should consider the accounting for related parties and nonoperating companies. We also believe that there may be significant overlap with the Boards's current project on consolidations and encourage the Board to be mindful of the business combinations project as it deliberates and reaches conclusions on related issues in the consolidations project.

Direction of the Project and How it Should be Conducted

This is a significant project that will broadly affect financial reporting. We commend the Board for soliciting comments with the Special Report and suggest that the project continue to be conducted in an equally comprehensive and deliberative process.

The Board should consider the work and views of other standards setters in its deliberative process. In doing so, the Board should make every effort to achieve the objective of developing high quality standards that, without sacrificing quality, minimize the differences between U.S. standards and those of other standards setters.

Detailed Responses to Issues Raised in the Report

1. What should the project's scope be?

   - How should business combinations be defined?

     Business combinations should be defined broadly.

     The scope should include unincorporated entities, nonoperating entities, and not-for-profit organizations, in order to provide guidance for the full range of transactions. If, during the course of the project, it appears that including not-for-profit organizations in the scope may unduly delay the project's completion, the Board may need to consider excluding them. However, we note that initially excluding not-for-profit organizations and subsequently including them may result in those entities being asked to justify departures from standards that were not developed considering the unique attributes of not-for-profit organizations and on which those organizations had no opportunity to provide input.

     The scope should include related parties. We note that AICPA Interpretation No. 39 of APB Opinion No. 16, *Transfers and Exchanges Between Companies Under Common Control*, provides guidance for related party transactions. Business combinations between related parties may not result in a change in control. The existence of related parties in a business combination raises significant issues in developing guidance for determining both the *reporting entity* and circumstances in which there has been a *change in control.* The Board should consider issues such as the definition of common control and the degree to which changes in control are required in order to conclude that there has been a change in control, or to conclude that a new basis should be recognized.

- Should alternatives to poolings for obtaining historical cost treatment be considered?

  Yes. This should be done in connection with addressing new basis accounting, which, we believe, would also include the reporting in the separate financial statements of the target company.

- Should intangibles other than purchased intangibles arising in business combinations be considered?

  No. In particular, the Board should not address internally generated intangible assets in this project. That is a broader topic that, if addressed, should be part of a separate project. However, the Board should be mindful in its deliberations that guidance pertaining to purchased intangibles resulting from this project may eventually, by analogy or otherwise, be extended to other purchased intangibles.

  The Board should reconsider the guidance in FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*.

  In addition to reconsidering current guidance, the Board should consider providing additional guidance concerning (1) purchase price allocations to intangible assets and (2) the method of subsequently expensing those assets, such as whether, and, if so, how, they should be amortized or tested for impairment.

2. What direction should the project take?

- Should the project seek to promote the international comparability of accounting standards for business combinations?

  The Board should consider and, if appropriate, build upon the work and views of other standards setters in its deliberative process. In doing so, the Board should make every effort to achieve the objective of developing high quality standards that, without sacrificing quality, minimize the differences between U.S. standards and those of other standards setters.

- How should the project approach the methods of accounting for business combinations?

  - Should the project seek to adopt a single method?

    No. In developing criteria for determining circumstances in which transactions should be reported using new basis accounting, one or more methods of accounting for business combinations may emerge. The focus should be on developing a sound model. The model, once developed, should determine whether one or more methods are needed.

  - Should the project seek to reduce the differences in accounting outcomes between poolings and purchases?

    No. If clear, operational, and conceptually sound guidance is provided, the differences, if any, will be supported by the underlying theory.

  - Should the project seek to modify the conditions specified for pooling-of-interests accounting?

    Yes. The rules for pooling of interests accounting are complex and result in financial reporting that often emphasizes the form over the economic substance of transactions. In the interest of developing standards that are operational and will be applied consistently, the Board should focus on developing guidance that is based on objective, verifiable evidence, rather than management intent or other criteria that are subject to differing interpretations. The guidance should be clear, operational, and should result in reporting that emphasizes the economic substance of transactions.

3. How should the project be conducted?

- How should international considerations be incorporated into the project?

- Should the project be conducted jointly or concurrently with other standard setters?

  We would not be opposed to the Board considering conducting the project jointly or concurrently with other standard setters. At a minimum, the Board should consider the work and views of other standards setters in its deliberative process. In doing so, the Board's objective should be to develop high quality standards that, without sacrificing quality, minimize the differences between U.S. standards and those of other standards setters.

- To what degree should the project leverage upon the work of other standards setters?

  As stated previously, the Board should consider the work of other standards setters. In particular, the Board should consider the effectiveness in practice of those other standards for business combinations.

• What should the project's structure and products be?

- How should the project be structured?

  To the extent practicable, administration of the project should be broken down into groups of issues that may be addressed on simultaneous tracks, with the goal of bringing the conclusions on those issues together in a single comprehensive standard. As stated previously, we believe the Board should address new basis recognition as a fundamental element of any project to reconsider business combinations. In addition, the Board should consider the accounting for business combinations and accounting for related intangibles simultaneously, because those issues are inter-related.

  We observe that there may be overlap between issues addressed in this project and other projects. For example, guidance concerning step-acquisitions and conclusions concerning the reporting entity may fall under the scope of both this project and the consolidations project. Therefore, the Board should be mindful of the business combinations project as it deliberates and reaches conclusions on related issues in the consolidations project.

Also, the issues related to transition may be significant and contentious. The Board should carefully consider the transition implications as it deliberates and reaches conclusions throughout the course of the project.

- What should the products of the project be?

The product of the project should be a single comprehensive standard.

The project should be conducted in a comprehensive and deliberative process. Also, the Special Report, while helpful in addressing certain issues pertaining to the project, should not be considered a substitute for a Discussion Memorandum, an Invitation to Comment, or a Preliminary Views Document. We believe the Board should seek periodic input through issuance of one or more documents in addition to an ED. The 1976 Discussion Memorandum may be useful in developing other document(s) for seeking input on the project.

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Representatives of AcSEC will be pleased to discuss these comments with the Board or its representatives.

Sincerely,

David B. Kaplan ds   Joseph H. Cappalonga ds

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Chair
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