10 Paragon Drive
Montvale, NJ 07645-1760
Tel: 800-638-4427, 201-573-9000
Fax: 201-573-8185

IMA

Certified Management Accountant Program
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CL 128

May 9, 2003

Ms. Annette Kimmitt
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Exposure Draft (ED) 3, "Business Combinations"

Dear Ms. Kimmitt,

The Financial Reporting Committee (FRC) of the Institute of Management Accountants is pleased to submit its comments on the IASB's ED 3, "Business Combinations" (ED). We congratulate the IASB on its tentative decisions to eliminate the pooling-of-interests method and to cease amortization of goodwill. We believe that these changes, if enacted as proposed, represent significant steps in the Board's efforts to achieve international convergence. We support these convergence efforts and are pleased to see the substantial progress that has been made in narrowing differences with US GAAP in this ED. However, we note that a number of the purchase accounting principles ostensibly in the ED have already been effectively superseded by the IASB in subsequent decisions it made over the past 5 months under its joint project with the FASB. These subsequent decisions are critically important and some of our members are concerned that based on the timing of the ED and the consequent lack of responses from the preparer community, these more recent decisions may find their way into the final revision without re-exposure. Our comments on these issues are discussed further below.

The FRC notes that the timing of the ED (issuance in December with a comment deadline in early April) made it difficult to prepare a detailed response. It is important for the IASB to note that preparers have spent virtually all of the elapsed time covered by the comment period dealing with annual report and 10K preparation, board meetings and other year-end activities. As a result, we are quite concerned that the timing of the exposure draft's issuance and the length of the comment period may have inadvertently stymied responses from the preparer community. We understand that the timing resulted from the IASB's goal of completing revisions to IAS 22 in advance of the adoption of IAS standards by European companies by

January 1, 2005. We believe that this goal will be achievable if the scope of the proposed revisions is scaled back to address methods of accounting for business combinations and accounting for goodwill. We also believe, for reasons discussed below, that the remaining proposals are sufficiently important and pervasive in their effect on existing practices that they should be addressed in tandem with Phase II of the FASB's project to ensure that their implications are given full and fair consideration by all constituents.

As discussed below, the IASB's subsequent deliberations on Phase II principles include a number of significant decisions that are different from those exposed in ED, including:

- Transaction costs – The IASB has concluded that these costs should be excluded from the cost of the business combination and expensed as incurred.

- Measurements of Assets and Liabilities – The IASB supports a "market participants" approach to determining fair value that is based on different methodologies than those presently employed in valuations of acquired assets.

- Contingent consideration – The IASB intends to require that contingent consideration be recorded up front at fair value and, in many cases, marked to market through earnings subsequent to the acquisition.

- Contingent liabilities – The IASB would require these liabilities to be measured at fair value and marked to market through earnings each reporting period.

- Carry-over basis for minority interest – The IASB would require 100% of acquired assets and liabilities to be recorded at fair value, not simply the portion purchased, resulting in gross-up of minority interest.

These decisions are both fundamental and significant in their implications for business combinations and other aspects of our accounting model. For example, our accounting model has historically treated transaction-related fees as part of the cost of acquiring the asset. In much the same way that transportation and installation expenses are part of the cost of a fixed asset, fees for valuation, legal and advisory services are an integral part of acquiring a business. The principles related to accounting and measurement of contingent consideration and contingent liabilities as well as the economic unit approach to presentation of minority interest introduce new, untested ideas that ought to be the central focus of Phase II of the FASB's Business Combinations project. The FRC therefore believes that these principles should be exposed for public comment before they are finalized which would require that they be excluded from the present IAS 22 revision.

Other Matters

The ED requires the disclosure of revenues and profit of the acquired entity for the year after the acquisition. While the FRC agrees that comparability of financial results prior to and after an acquisition is important, there are many cases in which such data is not available or is impossible to calculate. Combinations of consulting companies are a good example. When an acquired consulting company is integrated into the acquirer's consulting business shortly after the acquisition, legacy and acquired consultants jointly lead projects and share overhead and office space. Other than a highly arbitrary allocation, the acquirer in this situation would be hard-pressed to produce meaningful revenue and profit of the acquired company after the acquisition. We recommend that such disclosure should only be required in cases whereby the acquired company has not been integrated into the acquirer's company on an operational or financial record keeping basis.

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In summary, the FRC is pleased by the efforts to achieve international convergence with respect to the items in the FASB Business Combination Phase I project. We do, however, believe that the IASB should restructure the timing of when the conclusions related to Phase II of the project are exposed and finalized to be consistent with the FASB's due process. This will ensure that the IASB will receive the full consideration of U.S. preparers, who may not have had the opportunity to respond to the ED. We appreciate your consideration of our comments and welcome the opportunity to discuss these issues with the IASB at its convenience. If you have questions regarding this letter, please feel free to contact me at (203) 373-3563.

Sincerely,

Mitch Danaher

Mitchell A. Danaher
Chair, Financial Reporting Committee
Institute of Management Accountants