If you think new accounting rules will make acquisitions more transparent, think again. **By Andrew Osterland**

**Back to Basics?**

At face value, FAS 141 and 142, the new purchase-accounting rules issued by the Financial Accounting Standards Board, would seem to be another blow to a mergers-and-acquisitions market already down in the dumps. The new disclosures required of companies about their mergers will, in theory, provide investors with more-meaningful information about the performance of acquired businesses and, by extension, of the managers who execute the deals.

Under the former pooling-of-interests accounting method, the purchase price of a company was unaccounted for after the deal was done. And under the old purchase-accounting method, goodwill amortization charges could be passed off as meaningless bookkeeping entries. The new rules, which force companies to annually review the value of acquired goodwill and book impairment charges if that value drops, would seem to hold managers more directly accountable for the prices they pay for other companies.

Why then would Pfizer Inc. offer a hefty 44 percent premium over market price for Pharmacia Corp.?

With Pfizer's purchase of Pharmacia, "we have an opportunity to be the poster child for the new purchase-accounting method," says Shedlarz.

In the largest deal of the year, the pharmaceuticals giant forked out $60 billion in stock for Pharmacia, which on June 30 had a book value of just $12.2 billion. Pfizer has yet to issue financial statements reflecting the Pharmacia purchase. "We have an opportunity to be the poster child for the new purchase-accounting method," says David Shedlarz, Pfizer's chief financial officer.

**INTANGIBLE SAFETY NETS**

Like all CFOs involved with mergers, Shedlarz has had his hands full in the wake of FAS 142. The new rules require him to allocate the $60 billion purchase price to Pfizer's existing business units. He also has to mark up Pharmacia's assets to fair value and identify intangible assets to be amortized going forward. "I like the pooling-of-interests method better," says Shedlarz.

At the end of the day, however, the new...
have less unrecognized intangible value or because they may set up the acquired business as a stand-alone unit, will have a greater risk of impairment charges down the road—and quite likely problems with investors. At large companies, on the other hand, the acquired company would have to plummet in value because impairment would become an issue (see "How 1 + 1 = 3," page 31).

The solution, says Alfred King, vice chairman of Valuation Research, is to put a value on internally generated intangible assets, something currently on the FASB agenda. That, of course, would create huge amounts of new business for appraisal experts like King. But it would also prevent companies from subsuming acquired goodwill within undervalued business units, and from ever having to take impairment charges. "It would have a big impact on pricing for acquisitions," says King.

In the case of Pfizer, Pharmacia's assets and goodwill would be distinguishable from Pfizer's own business, and if it were to deteriorate, it would be visible to the market. As the rules now stand, deterioration would likely go unnoticed. "Pfizer's book value is way below its market value, so it's easy to slip in a lot of goodwill without risking future impairment," says King.

If FASB's intent is to make the performance of acquisitions more transparent to the market, it has work to do beyond FAS 142. *

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**Writing It All Off**

The best time to break bad news is when everybody else is, too. Following that rule of thumb, most companies with large amounts of goodwill on their balance sheets have written off huge portions of it in the initial impairment reviews mandated by FAS 142. With all the noise that accompanies a collapsing stock market, mega-write-offs due to accounting changes haven't garnered a lot of attention. "The effects of an accounting policy change are likely to be discounted or ignored by the market," says accounting analyst Bob Willens of Lehman Brothers. "We tell clients, if they're going to have an impairment, take it big and take it this year."

AOL: Time Warner, for example, took a charge of $54 billion in the first quarter, erasing more than 40 percent of the combined company's balance of goodwill. Last year, JDS Uniphase, the once high-flying manufacturer of optical networking gear, wrote off more than $50 billion of goodwill arising from various acquisitions, including SDL and E-Tek Dynamics. "The prevailing view is that if a company is at all at risk of a write-down in the next two or three years, it should take it now," says Alfred King, vice chairman of Valuation Research.

The upside of the strategy is that going forward, there is less goodwill remaining to suffer possible impairments. The potential downside is that companies that use conservative valuation methodologies in their initial impairment reviews have to stick with those same methodologies in their future reviews. The valuation alternatives boil down to three choices: the evaluation of comparable assets sold in the market, the cost of replacing the collection of assets, or the present value of expected future cash flows from the assets.

Whichever method a company chooses, it has to apply it consistently for all future reviews. "If a company writes down its goodwill to fair value and its business prospects continue to decline, it will have more impairments down the road," says Mark McDade, a partner at PriceWaterhouseCoopers. And after this year, the occurrence of impairment charges to goodwill, regardless of their size, will likely have a lot more negative impact in the market. + A.O.