

MINUTES



Financial Accounting
Standards Board

To: FASB Board Members

From: Yang (x447)

Subject: Minutes of the October 29, 2008 Board Meeting: Assets and Liabilities Arising from Contingencies in a Business Combination

Date: November 11, 2008

cc: FASB: Golden, Bielstein, Proestakes, Stoklosa, Inzano, Elsbree, Vernuccio, Lott, Posta, Glotzer, C. Smith, Mechanick, Bossio, Tatore, Maples, Chookaszian, Gabriele, Allen, Klimek, FASB Intranet; IASB: Leisenring, Brown

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topic: Assets and Liabilities Arising from Contingencies in a Business Combination

Basis for Discussion: Board Memorandum 2

Length of Discussion: 1:30–3:30 p.m.

Attendance:

Board members present: FASB: Herz, Seidman, Siegel and Smith
IASB: Leisenring

Board members participating by phone: FASB: Linsmeier

Board members absent: None

Staff in charge of topic: Inzano

Other staff at Board table: FASB: Golden, Proestakes, Elsbree, Yang

Summary of Decisions Reached:

At the October 29, 2008 meeting, the Board reached the following decisions on a proposed FSP to amend current requirements for accounting for assets and liabilities arising from contingencies in a business combination in FASB Statement No. 141 (revised 2007), *Business Combinations*.

The Board agreed not to include contingent consideration in the scope of the project. The Board determined that initial recognition and measurement of assets and liabilities arising from contingencies should follow a model similar to the one in FASB Statement No. 141, *Business Combinations*, with additional clarification of situations under which fair value is “reasonably estimable,” similar to the requirements in FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*.

The Board agreed to retain the subsequent measurement and accounting guidance in Statement 141(R) for assets and liabilities initially recognized at fair value, with additional clarification to address derecognition.

The Board determined that disclosures should include the nature of the contingency, the measurement attribute applied, and, if not measured at fair value, the reason that fair value could not be reasonably estimated. Additional disclosures would depend on the initial measurement attribute applied.

The effective date of this FSP will be the same as Statement 141(R).

Objective of Meeting:

The objectives of the meeting were for the Board to discuss (1) issues raised by constituents on the accounting for assets and liabilities arising from contingencies in a business combination and (2) whether to issue a proposed FSP that would amend FASB Statement No. 141 (revised 2007) *Business Combinations* (Statement 141(R)), to address those issues.

Matters Discussed and Decisions Reached

Issue 1—Contingent Consideration

1. Ms. Inzano stated that most contingent consideration relates to the performance of the acquired entity, such as meeting earnings targets. The concerns noted regarding preacquisition contingencies by the constituents would only apply to contingent consideration if the contingent consideration is tied to a preacquisition contingency. The staff believes this type of arrangement will be rare because uncertainties related to contingencies will generally be addressed through indemnification arrangements.
2. Ms. Inzano stated that the staff had also considered whether the contingent consideration arrangement of an acquiree assumed in a business combination would be considered preacquisition contingencies by the acquirer and subject to the scope of the project. The staff, however, believes that the nature of the contingent consideration does not change upon subsequent acquisition of an entity by another entity, and thus contingent consideration of an acquiree would not be considered a preacquisition contingency.
3. Ms. Inzano stated that the staff does not recommend including contingent consideration in the scope of this project.

Issue 1 Board Comments

4. None.

Issue 1 Board Vote

5. The Board unanimously agreed with the staff's recommendation not to include contingent consideration in the scope of this project.

Issue 2—Initial Measurement and Recognition of Preacquisition Contingencies

6. Ms. Inzano stated that there are three alternatives related to initial recognition and measurement for the Board to consider. These alternatives are meant to be a temporary solution to implementation issues raised until the Board determines whether to separately address the accounting for all contingencies.

7. *Alternative 1: No change from the initial recognition and measurement guidance in Statement 141(R)*

Ms. Inzano stated that under this alternative, the staff would recommend that the Board provide clarifying guidance on determining what is a contractual versus noncontractual contingency and address subsequent measurement and derecognition issued raised by constituents. However, this alternative would not address the concerns raised about litigation contingencies.

8. *Alternative 2: Apply the initial recognition and measurement guidance required for contingencies arising outside of a business combination*

Ms. Inzano stated that under this alternative, Interpretation 45 would apply to guarantees, and Statement 143 and Interpretation 47 to assets retirement obligations (AROs). Statement 5 would apply to all contingencies not subject to other specific guidance. Ms. Inzano noted that contingent assets would not be recognized under this alternative.

9. Ms. Inzano stated that this alternative would address concerns raised by constituents about the ability to reliably determine the fair value of a litigation contingency and eliminate the contractual and noncontractual and derecognition implementation questions raised by constituents.

10. Ms. Inzano stated that opponents of this alternative believe there are a number of contingencies for which fair value is determinable that are not currently being accounted for at fair value, such as warranty obligations, and it would not be appropriate to allow these contingencies to be recognized at something other than fair value when they are acquired in a business combination.

11. *Alternative 3: If fair value is determinable, recognize at fair value as of the acquisition date. If fair value is not determinable initially recognize and measure in accordance with guidance required for contingencies arising outside of business combination*

Ms. Inzano stated that this alternative is essentially the guidance under Statement 141. Under this alternative, contingent assets would be recognized at fair value if determinable. This alternative would address concerns raised by constituents about the ability to reliably

determine the fair value of a litigation contingency and eliminate the contractual and noncontractual implementation question raised by constituents.

12. Ms. Inzano stated that some opponents of this alternative believe entities will continue to assert that the fair value of most preacquisition contingencies is not determinable. Other opponents of this alternative believe the adoption of Statement 157 will create tension between auditors and preparers in determining whether fair value is determinable. Ms. Inzano noted that these concerns can be alleviated by adopting guidance similar to that included in Interpretation 47 to assess whether fair value is determinable.
13. Ms. Inzano stated that the staff recommends Alternative 3.

Issue 2 Board Comments

14. The Board agreed that Alternative 3 would be closest to IFRS 3, while Alternative 2 would be the farthest. Mr. Linsmeier stated that whichever alternative is chosen, it should only be an interim solution to address issues raised and that he would like the FASB to join IASB at a certain point to tackle all issues related to all contingencies. Mr. Herz stated that based on the unique legal system in the United States, U.S. companies would likely be unwilling to adopt IFRS without a “carve-out” for the requirement to fair value litigation-related contingencies. Mr. Linsmeier responded that the goal should be to openly discuss such issues with the IASB to come up with a non-carve-out solution.
15. Mr. Linsmeier questioned whether the guidance in Interpretation 47 is strong enough to alleviate the tension between the auditors and prepares on deciding whether fair value is determinable. Mr. Smith added that although it is not directly required in Statement 141, for many contingencies, such as guarantees, warranties and certain AROs, fair value should generally be determinable. Mr. Linsmeier and Mr. Herz commented that Interpretation 47 was written for one specific context (AROs), therefore, it may not be appropriate for all contingencies. Mr. Golden stated that the staff would work on the language so that it would apply to all contingencies.
16. Both Ms. Seidman and Mr. Linsmeier indicated that they prefer the language of “reasonably estimable” to “determinable” when addressing fair value.

17. The Board concurred that Footnote 14 in Statement 141 should not be included in the proposed FSP.

Issue 2 Board Vote

18. The Board agreed with staff's recommendation of choosing Alternative 3 but asked the staff to work on clarifying situations under which fair value is "reasonably estimable," similar to the requirements in Interpretation 47.

Issue 3—Subsequent Measurement

19. Ms. Inzano stated that Alternative 3 would potentially require fair value measurement of contingencies not previously recognized at fair value. Ms. Inzano asked whether the Board wanted to reconsider the subsequent measurement guidance in Statement 141(R) to address questions raised by constituents about derecognition of a contingency. Ms. Inzano indicated that there were two alternatives: (a) retain the subsequent measurement guidance in Statement 141(R) and separately address derecognition issues, or (b) require remeasurement of all preacquisition contingencies initially recognized at fair value at each reporting period.

Issue 3 Board Comments

20. Mr. Golden stated that derecognition issue only exists when subsequent measurement requirements in Statement 141(R) is retained. Mr. Linsmeier stated that the requirements in Statement 141(R) only cause unnecessary complication and subsequent fair value remeasurement should be adopted. Mr. Smith indicated the problem of adopting fair value remeasurement is that there will be two measurement attributes for liabilities, one for self-generated liabilities and the other for acquired liabilities. Ms. Seidman stated that the "higher-of/lower-of" notion also appears in the revised IFRS 3. Ms. Inzano noted that the international standards provide some guidance for amortizing the acquisition-date fair value. Ms. Seidman stated that the language in Statement 141(R) could result in the acquisition-date fair value being recorded on the books in perpetuity, which is not what the Board intended. Ms. Seidman suggested including language similar to that included in the revised IFRS 3 to allow for subsequent amortization of the acquisition-date fair value. Mr. Smith and Mr. Siegel agreed. Mr. Linsmeier did not agree and continued to support fair value remeasurement of contingencies.

Issue 3 Board Vote

21. Four Board members agreed to retain the subsequent measurement and accounting guidance in Statement 141(R) for assets and liabilities initially recognized at fair value with certain clarifications to allow for subsequent amortization of the acquisition-date fair value (Herz, Seidman, Siegel, Smith). Mr. Linsmeier voted against it and will dissent to the document.

Issue 4—Derecognition

Issue 4 Board Comments

22. Mr. Herz suggested derecognizing contingent liabilities when risk of loss becomes remote. The Board and the staff concurred that a Day 2 gain would not be appropriate, so new information must be obtained to indicate that the risk of loss has become remote. Mr. Linsmeier questioned how the auditors would decide there is new information and continued to support fair value remeasurement of contingencies to allow for a reduction of a contingent liability when circumstances change. Ms. Seidman suggested asking for feedback with the Exposure Draft on whether such a derecognition requirement is operational. The other Board members agreed.

Issue 4 Board Vote

23. The Board agreed to allow for the derecognition of a contingent liability when new information is obtained that indicates the risk of loss has become remote.

Issue 5—Disclosure

24. Ms. Inzano stated that the Board is in the process of redeliberating the Exposure Draft on the disclosure of certain loss contingencies that will amend both the disclosure requirements in Statement 5 and Statement 141(R). The staff believes that many of the concerns raised in the Exposure Draft would also apply to the requirements currently included in Statement 141(R). Additionally, the Board has recently received unsolicited comment letters related to Statement 141(R) expressing concern over the disclosure requirements in Statement 141(R). Because there is a current project to require enhanced disclosures of certain loss contingencies, including contingencies arising from a business combination, and because of significant concerns raised by constituents, the staff recommended that the disclosure

requirements in Statement 141(R) be replaced with the requirements in Statement 5 until that project is complete.

Issue 5 Board Comments

25. Mr. Linsmeier asked the staff what disclosure requirements in Statement 141(R) are problematic or not useful. Mr. Elsbree responded that they are: the estimated range of outcomes, the nature of unrecognized loss contingencies, and the initial recognized amount of loss contingencies. Mr. Smith stated that the disclosure requirements in Statement 141(R) should be possible for contingencies that are not litigation-related. Mr. Linsmeier indicated that entities should also be required to disclose a subsequent change from acquisition-date fair value to the amount that would be recognized under Statement 5. Mr. Golden stated that the disclosure requirements should not be solely replaced by the ones in Statement 5 because certain contingencies can be measured at fair value. Mr. Golden suggested that required disclosures should include the nature of the contingency, the measurement attribute applied, and, if not measured at fair value, the reason that fair value could not be reasonably estimated.

Issue 5 Board Vote

26. The Board determined that disclosures should include the nature of the contingency, the measurement attribute applied, and, if not measured at fair value, the reason that fair value could not be reasonably estimated. Additional disclosures would depend on the initial measurement attribute applied.

Issue 6—Effective Date and Comment Period

27. Ms. Inzano stated that the staff recommends the proposed FSP be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The staff recommends a comment period of 45 days. With a comment period of 45 days, the proposed FSP will not be finalized prior to December 15, 2008. However, the guidance would be issued before the end of the first interim reporting period in which Statement 141(R) is required.

Issue 5 Board Comments

28. Mr. Smith asked the staff when they would have the proposed FSP ready for distribution to the public. Mr. Golden responded that the earliest date would be the end of November. Ms. Seidman noted the comment period is very likely during the winter holiday. Therefore, it may not give the public enough time for consideration. Ms. Seidman asked the staff if the drafting process can be shortened. Mr. Linsmeier stated that the plan of issuing the proposed FSP by the end of November is already aggressive based on the previous discussion on subsequent measurement and disclosure. Ms. Seidman indicated that to get the proposed FSP out for comment as soon as possible is in everyone's best interest. Mr. Golden suggested, and the Board agreed, that the comment period end on January 15, 2009, with the number of days for comment depending on the date the proposed FSP is issued (for example, the period would be 45 days if the proposed FSP is issued on December 1 and 30 days if issued on December 15).

Issue 5 Board Vote

29. The Board agreed that the comment period for the proposed FSP should end on January 15, 2009.

Follow-Up Items:

None.

General Announcements:

The Board officially announced it added Assets and Liabilities Arising from Contingencies in a Business Combination to its agenda.