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January 15, 2009

Technical Director – File Reference: Proposed FSP FAS 141(R)-a Financial Accounting Standards Board 401 Merritt 7

LETTER OF COMMENT NO.

PO Box 5116 Norwalk, Connecticut 06856-5116

> RE: Proposed Staff Position, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies (File Reference Proposed: FSP FAS 141(R)-a)

Dear Technical Director:

We appreciate the opportunity to respond to the proposed FASB Staff Position, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies (the "proposed Staff Position"). We agree with the Board's stated objectives to improve financial reporting by addressing application issues identified by preparers, auditors, and members of the legal profession about FASB Statement No. 141(R), Business Combinations ("Statement 141(R)"), related to the initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. However, as discussed below, we do not agree with certain provisions of the proposed Staff Position pending completion of a broader project to address the accounting for all contingencies.

While we support the overall objectives of the proposed Staff Position, we believe that the Board should put back on its agenda the project on recognition and measurement of all contingencies, including those acquired or assumed in a business combination and those that arise outside of a business combination under FASB Statement No. 5, Accounting for Contingencies. We understand and support the Board's action to address the accounting for contingencies acquired in business combinations based on concerns raised by constituents about the application of Statement 141(R). However, we believe that the Board's ultimate objective should be to comprehensively reconsider the accounting for all contingencies in an effort to establish a single accounting model for the initial recognition and measurement, subsequent accounting, and disclosure of all

¹ On June 11, 2008, the FASB announced that the second phase of its project on accounting for contingencies, which was to address recognition and measurement of contingencies, "was removed from the Board's agenda because the Board plans to consider at a future date whether to address the accounting in a joint project with the IASB." (From the Disclosure of Certain Loss Contingencies project update on the FASB's website.)

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contingencies. Paragraph C15 in the Basis for Conclusions and Alternative View of the proposed Staff Position acknowledges that the Board "decided not to require subsequent measurement at fair value, primarily because it would result in different measurement of assets and liabilities arising from contingencies acquired in a business combination than of other similar assets and liabilities not acquired in a business combination; that would make financial reports more difficult to understand." We agree with the Board's concerns and believe those concerns should be addressed in the project on recognition and measurement of all contingencies. That project should also include the initial recognition and subsequent accounting for contingencies in a business combination. We also encourage the Board to consider making the project on recognition and measurement of contingencies a joint project with the International Accounting Standards Board ("IASB"). We believe that a joint project with the IASB is an important part of the overall objective of convergence of U.S. GAAP with International Financial Reporting Standards ("IFRS").

Until the Board is able to undertake and complete an overall project on accounting for all contingencies, we believe that the Board should carry forward the existing requirements of FASB Statement No. 141, Business Combinations, related to contingencies without reconsideration as an interim step. This interim step would avoid the risk that preparers might be required to change accounting policies twice - once to adopt the proposals in the proposed Staff Position and once again upon completion of the broader project to reconsider the accounting for all contingencies. Additionally, carrying forward the guidance in Statement 141 reduces the need to provide new and complex guidance on subsequent measurement and derecognition. The retention of the existing Statement 141 model for accounting for contingencies arising in business combinations is appropriate in the interim until the accounting for all contingencies is broadly addressed and retaining that model will be more understandable by preparers, auditors, and financial statement users than the complex guidance that is provided in the proposed Staff Position. We also believe that retention of the Statement 141 model will reduce concerns by the preparer community, the auditing profession, and the legal profession over whether legal counsel will be able to provide the necessary information to support the amounts recognized in the preparers' financial statements.

We also suggest that the Board coordinate its efforts with the PCAOB and AICPA so they can evaluate whether further standard-setting or some other form of guidance is necessary on auditing contingencies assumed in a business combination. We believe that the PCAOB and AICPA should collaborate with the American Bar Association ("ABA") to determine if the new requirements in the proposed Staff Position require any amendments to the ABA's Statement of Policy Regarding Lawyers' Responses to Auditors' Requests for Information and related auditing literature. For instance, paragraph 13 of the proposed

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Staff Position states that the Board expects that sufficient information may be available to measure the acquisition-date fair value of assets and liabilities arising from contingencies in a business combination, including "some legal contingencies in the later stages of the case." We believe that the privilege issues described in paragraphs C6 and C7 of the proposed Staff Position may still be present for legal contingencies where the Board believes that acquisition-date fair value may be reasonably determinable. For those legal contingencies, we believe that the proposed Staff Position may not be operational and therefore the Board should collaborate with the PCAOB, Auditing Standards Board, and ABA so that preparers and auditors can obtain the appropriate information from legal counsel to support amounts recognized in the preparers' financial statements.

Acquisition-Date Fair Value – Legal Contingencies

We understand that in order to promptly address concerns raised by constituents for the application of Statement 141(R), the Board has proposed a model "similar" to the guidance in Statement 141 for the initial recognition and measurement of assets and liabilities arising from contingencies in business combinations. However, the proposed Staff Position indicates that there is an expectation that in many cases the fair value of an asset acquired or liability assumed in a business combination that arises from a contingency may be reasonably determined, and the proposed Staff Position may be interpreted that it would be the unusual fact pattern where entities would conclude that fair value is not reasonably determinable. In particular, we have concerns about loss contingencies arising from litigation-related matters and the ability to reasonably determine their acquisition-date fair value. We understand that the Board has acknowledged those difficulties in paragraphs 13 and C13 of the proposed Staff Position, stating that "the fair value of a liability arising from a legal contingency may not be reasonably determinable", and providing illustrative guidance in Example 1 of the proposed Staff Position where the acquisition-date fair value of a litigation-related contingency could not be reasonably determined. We agree with that guidance and believe that, in many cases, assets and liabilities related to litigation-related contingencies were not previously recognized at fair value in business combinations accounted for under Statement 141 due to the inherent difficulty in determining the fair value of legal contingencies. However, it is not appropriate for the Board to establish an expectation regarding whether or not the threshold will be met, particularly prior to an overall reconsideration of accounting for all contingencies.

The Board's proposed lower threshold for measuring contingencies at fair value also is evident by the proposed Staff Position's use of reasonably determinable as contrasted with determinable in Statement 141. For example, footnote 14 of paragraph 40 in Statement 141 states that "if it can be demonstrated that the parties to a business

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combination agreed to adjust the total consideration by an amount because of a contingency, that amount would be a **determined** fair value of that contingency." (emphasis added) In practice, we believe that the example cited in that footnote rarely occurred and that legal contingencies often were not recognized at their acquisition-date fair value, as fair value was deemed not to be determinable. The guidance in paragraph B182 of Statement 141 also supports that assessment as it states that "the criteria were provided because the fair value of a preacquisition contingency usually would not be determinable."

Accordingly, in order to address the concerns that gave rise to the need for the amendments to Statement 141(R) as described in paragraph 4 of the proposed Staff Position on a more comprehensive basis, we believe that it would be more appropriate for the Board to carry forward the guidance in Statement 141 on contingencies until the Board addresses the accounting for all contingencies in a broader project.

Subsequent Accounting - New Information

We agree with the Board member's conclusion in paragraph C33 of the proposed Staff Position that the subsequent accounting for assets and liabilities arising from contingencies in a business combination that are recognized at their acquisition-date fair value is extremely complex and may result in unintended consequences and potentially inconsistent application by financial statement preparers, and confusion by financial statement users. For instance, for a liability arising from a contingency that is recognized at fair value at the acquisition date, if the acquirer is not released from risk and does not fulfill its performance obligation over time, the acquirer continues to report the liability at its acquisition-date fair value until the liability is settled, the obligation to settle is cancelled or expires, or "new information" about the possible outcome of the contingency is obtained that indicates that it has become remote that the obligation will be enforced. The requirement for evaluating whether an acquirer has obtained new information about the possible outcome of a contingency introduces significant complexity into the subsequent accounting for assets and liabilities arising from contingencies in business combinations recognized at their acquisition-date fair value.

Furthermore, paragraph 7 of the proposed Staff Position requires that an acquirer recognize the acquisition-date fair value of an asset acquired or liability assumed in a business combination that arises from a contingency if the fair value of that asset or liability is reasonably determinable during the measurement period, without consideration of a recognition threshold for fair value. With no recognition threshold, an asset or liability arising from a contingency in a business combination would be recognized if the acquisition-date fair value is reasonably determinable even if the possible outcome of

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performance of the obligation is remote. For example, in a circumstance where there is a 3% chance of paying \$1 million to fulfill a performance obligation related to a contingency assumed in a business combination and a 97% chance of paying \$0, the contingency would be recognized at its acquisition-date fair value even though the obligation to perform is remote. Likewise, in a circumstance where there is a 90% chance of paying \$1 million to fulfill a performance obligation related to a contingency in a business combination and a 10% chance of paying \$0, the contingency would be recognized at its acquisition-date fair value. We believe that there may be questions in practice and inconsistencies may arise in application unless the Board addresses the subsequent accounting for similar circumstances. For instance, would the contingency in the first example be derecognized immediately after the business combination since it is remote that an obligation will be enforced, or alternatively, would the contingency remain at its acquisition-date fair value since there is no new information about the contingency, and in which case, when would it be derecognized? In the second example, since there is no new information immediately after the business combination, would the contingency continue to be measured at its acquisition-date fair value or under Statement 5 if the amount that would be recognized under Statement 5 is higher than the acquisition-date fair value?

Those relatively simple examples highlight some of the complexities in application of the subsequent accounting for assets and liabilities arising from contingencies in business combinations recognized at their acquisition-date fair value. Preparers are likely to encounter significantly more complex facts and circumstances than those relatively simple examples which may require additional guidance to produce consistent application. We believe that much of that complexity can be avoided pending completion by the Board of a broader project on accounting for all contingencies by carrying forward the existing provisions on contingencies in Statement 141 and eliminating the Board's expectation that more liabilities from contingencies should be recognized than under prior practice.

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We would be happy to further discuss the specifics of these issues in more detail at the request of the Board or the staff. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419, Paul Munter at (212) 909-5567, or Brenna Wist at (212) 909-5609.

Sincerely,

