



LETTER OF COMMENT NO. 18

January 16, 2009

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference: Proposed FSP FAS 141(R)-a

Dear Mr. Golden:

We appreciate the opportunity to comment on the Exposure Draft of the Proposed FASB Staff Position, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (the "Exposure Draft"). Huron Consulting Group helps clients address complex challenges that arise in litigation, disputes and investigations. Huron provides services to a wide variety of organizations, including Fortune 500 companies, medium-sized businesses, leading academic institutions, healthcare organizations, and the law firms that represent these various organizations.

We agree with the Board's decision to amend paragraph 24 of FASB Statement No. 141 (revised 2007), *Business Combinations* ("SFAS 141(R)"). We believe the requirement to distinguish between contractual and non-contractual contingencies would have led to diversity in practice. We also believe the requirement that a company determine whether it would more likely than not have a liability arising from litigation would have created potential issues, such as inadvertent waivers of privilege or the disclosure of information that would be prejudicial to a company's defense. Further, we believe that guidance would ultimately have led to audit issues because counsel to a company on a matter would not be able (or willing) to provide the information required by an independent auditor to support the need for a litigation accrual recognized in a business combination.

However, we have a number of comments on matters addressed in the Exposure Draft for the Board's consideration.

Scope

Paragraph 6(b) of the Exposure Draft states that paragraphs 41, 42, and 65 of SFAS 141(R) address the accounting for an acquirer's contingent consideration arrangements

assumed by the acquirer. While we don't necessarily object to that conclusion, we note that paragraph 3(f) of SFAS 141(R) defines "contingent consideration" as:

... an obligation ... to transfer additional assets or equity interests to the former owners of the acquiree as part of the exchange for control of the acquiree.

Technically, an acquirer has not agreed to transfer additional assets or equity interests to the former owners of the acquiree when it assumes the acquiree's obligation to make payments under a contingent consideration arrangement that the acquiree previously entered into because the beneficiaries under those arrangements were not owners of the acquiree. We believe accounting for a contingent consideration arrangement assumed in a business combination as a pre-acquisition contingency is more consistent with the definitions in SFAS 141(R). If the Board disagrees, it should consider revising the definition of "contingent consideration" to make it consistent with the Board's views on the appropriate subsequent measurement approach.

Initial Recognition and Measurement

Although we agree with the proposed change to require a company to recognize a liability if it can reasonably determine the fair value of that liability, we do not see the need for the additional guidance if fair value is not reasonably determinable. We note that the guidance in FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"), from which the Board drew the guidance reflected in paragraphs 10 and 11 of the Exposure Draft, requires a company to consider the potential methods of settlement when estimating the fair value of a conditional asset retirement obligation. Applying that requirement to a contingency arising from litigation, a company would need to consider the potential methods for settling the contingency, including whether the company intends to make a settlement offer to the plaintiff. Because the concept of including potential methods of settlement is already part of the FIN 47 measurement model, we do not believe the Board needs to permit companies to apply FASB Statement No. 5, *Accounting for Contingencies* ("SFAS 5"), or FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss* ("FIN 14") in determining the amount they should recognize in an acquisition.

Because FIN 47 requires a company to consider the potential methods of settling a contingency, if a company asserts it cannot reasonably determine the fair value of a contingency, it seems inconsistent for the company to then assert it could estimate the accrual under SFAS 5/FIN 14. We believe that under FASB Statement No. 141, *Business Combinations* ("SFAS 141"), companies generally recognized a liability in purchase accounting for litigation they intended to settle based on the guidance in SFAS 5. If a company can estimate a liability based on its intent to settle litigation, we believe it should be able to reasonably determine the fair value of that contingency using that information.

Finally, we note that allowing a company to use SFAS 5 and FIN 14 as a basis for recognizing a contingent liability in an acquisition is inconsistent with the approach taken by the International Accounting Standards Board ("IASB") in IFRS 3, *Business*

Combinations ("IFRS 3"). Under IFRS 3, if the acquirer is unable to reliably estimate the fair value of an assumed contingency, it does not recognize the contingency in accounting for the acquisition. Although there are other areas in which SFAS 141(R) is inconsistent with IFRS 3, we believe the Board should attempt to avoid adding to them.

While we appreciate the Board responding to constituent concerns about the original guidance in SFAS 141(R), we note that the Exposure Draft does not address all questions raised by constituents. In particular, the Exposure Draft leaves unanswered questions related to what a company should include as part of the fair value of a contingency and how a company should subsequently account for the liability. For example, if a company expects to incur legal fees as part of settling a contingency arising from litigation, should it include the estimated legal fees as part of the initial measurement of fair value? Also, should the company subsequently accrete the liability so there is no difference between the accrual and the payments when made? Or, should it expense the difference between the payments it makes and the present value of those payments included as part of the acquisition date measurement? Even with the proposed changes, companies will continue to have those questions. We believe the Board should consider providing application guidance in these areas to address preparer concerns.

Paragraph 7 of the Exposure Draft requires an acquirer to recognize at fair value a contingent asset acquired or a contingent liability assumed in a business combination if fair value can be "reasonably determined." Paragraph 3 of FIN 47 requires a company to recognize a liability if its fair value can be "reasonably estimated." Does the different wording indicate a different level of assurance in the measurement? If not, we believe the Board should use the same wording in the final FSP that it used in FIN 47 to avoid confusion.

We note that paragraph 5(b)(2) of FIN 47 indicates that a liability is reasonably estimable if, among other criteria, a company has information about "the method of settlement or potential methods of settlement." Paragraph 10 of the Exposure Draft lists information that, if available, would lead to a conclusion that the acquirer can reasonably determine the fair value of a contingency. That list excludes "the method of settlement or potential methods of settlement." It is not clear why the Board elected to exclude that item from the list of information included in the Exposure Draft.

We recommend the Board delete paragraph 13 in the Exposure Draft. Because the determination of whether the fair value of a contingency is reasonably determinable is a matter of facts and circumstances, we believe that paragraph is unnecessary.

If the Board decides to retain the guidance permitting companies to apply SFAS 5 and FIN 14 in determining whether to recognize an amount for a contingent liability in acquisition accounting, we believe it should clarify the last sentence of paragraph 14 of the Exposure Draft. We are not sure what the Board means by "it must be probable at the acquisition date that one or more future events will occur confirming the existence of the asset or liability." Does that mean a company must conclude it is probable that a court will find it liable if it elected to litigate a particular matter, or just that it will make a settlement offer? We suspect it is not the former, since that interpretation would be

consistent with the original guidance in SFAS 141(R) that the Board is now replacing, but we are not sure.

Subsequent Measurement and Accounting

We believe the Board should adopt one approach for the subsequent measurement and accounting for contingent liabilities and one approach for contingent assets. We do not believe the basis used to initially recognize an asset or liability should affect the subsequent measurement and accounting for that asset or liability. We also believe that having multiple approaches to the subsequent measurement of and accounting for contingent assets and liabilities only contributes to complexity.

We believe the Board could simplify the subsequent accounting for contingent liabilities by eliminating the distinction arising out of the method used to determine the initial measurement. Depending on the nature of the contingent liability, the acquirer would follow one of the following approaches:

- If the acquirer is released from risk or fulfills its performance obligation over time, the acquirer would reduce the liability as it is released from the risk or fulfills its performance obligation.
- For other contingent liabilities, the acquirer should subsequently measure the liability in accordance with SFAS 5. However, the acquirer should only adjust the liability when it acquires new information about the contingency.

We believe a subsequent measurement and accounting approach based on the guidance in SFAS 5 makes more sense and is simpler than the approach outlined in paragraph 20 of the Exposure Draft. If the acquirer obtains new information about the possible outcome of the contingency, it would adjust the liability (either increase or decrease) to reflect the amount determined in accordance with SFAS 5.

We are concerned that the approach outlined in the Exposure Draft may serve to penalize companies that estimate the fair value of a contingent liability because they could not reduce the liability based on new information. In contrast, those companies that apply SFAS 5 in recognizing the liability could reduce that liability based on new information. This does not make sense to us and could serve as a disincentive to companies to try to estimate fair value. We believe only permitting a company to adjust a contingent liability recognized in acquisition accounting when it receives new information on the liability recognized should alleviate the Board's concerns expressed in paragraph C14 of immediate gains and losses on moving from fair value to SFAS 5. Requiring a company to wait to adjust the liability until it has new information, combined with the disclosures required by paragraph 27(b) of the Exposure Draft, would provide users sufficient information about any gains or losses from moving from fair value to SFAS 5.

If the Board decides to retain the guidance in paragraph 20 of the Exposure Draft, we encourage it to clarify how that guidance would apply to a liability recognized for a

contingency arising from litigation. What should the acquirer do if it determines it is remote that the plaintiff will pursue the litigation for which it recognized a liability in the acquisition? We assume that the acquirer would reduce the liability based on the guidance in paragraph 20(a) of the Exposure Draft, but it is not completely clear.

We also believe the Board should provide guidance on how an acquirer should measure a contingent liability where, because of enhancements in technology, it will cost the acquirer less to fulfill its performance obligation than expected at the acquisition date. This situation could arise in connection with environmental remediation liabilities. We do not believe the acquirer should maintain a liability at an amount that exceeds what it would cost to satisfy the obligation because of changes in facts and circumstances subsequent to the acquisition.

If the Board decides to retain the subsequent measurement and accounting guidance in paragraph 22 of the Exposure Draft, we believe it should add a sentence indicating that the acquirer should only adjust the liability recognized at the acquisition date on the basis of new information.

Finally, we note that the wording in paragraphs 23 and 24 of the Exposure Draft concerning contingent assets is essentially the same. Thus, we do not see the reason for having two paragraphs addressing the subsequent accounting for contingent assets.

Disclosures

We believe the Board should modify the proposed disclosures in paragraph 26 of the Exposure Draft. Although the Board notes in the basis for conclusions that it is not requiring disclosures beyond what SFAS 5 requires, we believe paragraphs 26(a) and 26(c) are not consistent with SFAS 5. Paragraph 9 of SFAS 5 requires a company to disclose amounts accrued if necessary to avoid financial statements that are misleading. Paragraph 26(a) of the Exposure Draft simply requires disclosure, without the proviso in SFAS 5. Paragraph 26(c) requires disclosure of the range of loss; paragraph 12 of SFAS 5 permits a company to state that it cannot reasonably estimate the range of possible loss on a matter. Therefore, the disclosures proposed in paragraph 26 exceed the disclosures required under SFAS 5. We recommend the Board simply refer to the disclosures required under SFAS 5.

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We would be pleased to discuss any of our comments with the Board or the FASB staff. Please direct any questions or comments to Jeff Ellis at 312-880-3019.

Sincerely,

/s/ Jeffrey H. Ellis

Jeffrey H. Ellis
Managing Director