

October 26, 2009

Mr. Russell Golden  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, Connecticut 06856-5116

File Reference No. EITF0902—Exposure Draft, *Research and Development Assets Acquired and Contingent Consideration Issued in an Asset Acquisition*

Dear Mr. Golden:

BDO Seidman is pleased to offer comments on the Exposure Draft of the Proposed Accounting Standards Update, *Research and Development Assets Acquired and Contingent Consideration Issued in an Asset Acquisition*. We agree that the manner in which research and development costs are incurred should not result in different methods of accounting. However, we do not support the ED because it does not align the accounting for intangible assets acquired in an asset acquisition with business combination accounting, but rather, it creates new inconsistencies in U.S. GAAP without a compelling benefit. Further, it does not align the accounting for acquired intangible assets with internally-generated R&D costs that must be expensed. If the Board concludes that improvements to the accounting for research and development activities are necessary, we believe they should be developed more comprehensively. Our thinking is explained in greater detail below.

#### Responses to Questions

**Question 1: Do you agree that the cost of acquired tangible and intangible research and development assets acquired in an asset acquisition should be capitalized, regardless of whether they have a future alternative use? Why or why not?**

We note the Board debated this question in the development of Statement 141(R)<sup>1</sup> and concluded that the cost of IPR&D acquired in a business combination meets the definition of an asset in Concepts Statements 6,<sup>2</sup> without considering if it has an alternative future use. We sense the Board is unlikely to reverse itself in this ED based on concerns that IPR&D projects often have a low likelihood of becoming profitable or that their measurement may be uncertain.

We also note the Board agreed with constituents who believe that inconsistent accounting for research and development costs depending on how they are acquired is undesirable. We share the same view. However, the ED would not resolve that inconsistency. IPR&D acquired in a business combination is measured at fair value, whereas the same asset obtained through an asset acquisition generally would be measured at cost under the ED (or a pro-rated allocation of cost, if purchased in a group). Further, the ED would create a difference with respect to accounting for contingent consideration that could significantly compound the initial measurement differences

---

<sup>1</sup> Statement of Financial Accounting Standards No. 141(revised 2007), *Business Combinations*

<sup>2</sup> Statement of Financial Accounting Concepts, *Elements of Financial Statements*



between assets acquired in a business combination vs. an asset acquisition (see our response to Question 2 below).

If the Board decides to conform the ED to the guidance in Statement 141(R) to avoid inconsistencies, differences would persist relative to other parts of GAAP. Internally generated research and development costs, including software development, will continue to be expensed even though a buyer would capitalize them in a business combination or an asset acquisition.

With respect to convergence, the ED states that its “proposed amendments will more closely align U.S. GAAP with IFRS, as research and development assets acquired in an asset acquisition are generally capitalized under IFRS.” It appears the assertion that IPR&D costs are generally capitalized under IFRS is due, at least in part, to the guidance in paragraph 25 of IAS 38<sup>3</sup> for assessing probability:

Normally, the price an entity pays to acquire separately an intangible asset reflects expectations about the probability that the expected future economic benefits embodied in the asset will flow to the entity. In other words, the effect of probability is reflected in the cost of the asset. *Therefore, the probability recognition criterion in paragraph 21(a) is always considered to be satisfied for separately acquired intangible assets.*

Without similar, unequivocal language in U.S. GAAP, it remains to be seen whether practice will converge on this point. In addition, the accounting for internally-generated R&D costs will continue to differ between U.S. GAAP and IFRS, since IAS 38 requires the capitalization of development costs if specified criteria are met.<sup>4</sup>

We believe a better approach would be to undertake a broad project to reconsider the accounting for all research and development activities, if the Board believes it would be an appropriate use of its resources to do so. This might be conducted as a joint project with the IASB, which could address differences in the language between the two sets of literature where the standards-setters share the same intent, as well as where the Boards’ intent differs (for instance, for certain internally-developed intangible assets).

As a practical matter, the application of existing U.S. GAAP for R&D activities is well understood, with little demand for additional interpretive standard-setting. If meaningful improvements can be made to the accounting for R&D activities, we believe all such activities should be treated similarly. In contrast, a piecemeal approach that only exchanges old inconsistencies for new ones seems to offer little, if any, net improvement to financial reporting.

**Question 2: Do you agree that contingent payment arrangements in an asset acquisition should not be recognized at fair value unless those arrangements are derivatives?**

We recognize instruments meeting the definition of a derivative under Topic 815 should be carried at fair value since no other measurement attribute provides more meaningful information for those contracts. However, the combination of a derivative instrument and other costs incurred to purchase an IPR&D asset (such as cash and transaction fees) results in a mix of measurement attributes. Requiring contingent consideration that does not meet the definition of a derivative to be recorded at initial recognition would only compound this mixture, and it is unclear how decision-useful the ending figure would be to users. Therefore, we agree with this element of the proposed guidance to apply Topic 450 for contingent consideration that does not meet the definition of a derivative, if the Board ultimately adopts the ED.

<sup>3</sup> International Accounting Standard 38, *Intangible Assets*, emphasis added.

<sup>4</sup> See paragraph 57 of IAS 38.



As an additional observation, we note business combination accounting requires contingent consideration to be recognized at fair value, even when such consideration is issued in the form of a derivative instrument that is *classified in equity* pursuant to Topic 815. However, the ED indicates “contingent consideration in an asset acquisition shall be accounted for in accordance with other Topics.” ASC 815-10-15 provides scope exceptions from derivative accounting for certain contracts, including some that are not traded on an exchange and others that involve an entity’s own equity. Consequently, only derivative *liabilities* will affect the initial measurement of an acquired asset under the ED. This particular inconsistency regarding the classification of derivatives between business combination accounting and asset acquisitions could be quite significant in future periods,<sup>5</sup> and it will only obscure the similar underlying business economics of comparable R&D activities for users.

**Question 3: This proposed Update does not provide guidance for determining whether a contingent payment relates to future services or consideration for the asset acquired. Paragraph 805-10-55-25 provides guidance for determining whether payments made to the seller in a business combination after the acquisition date relate to the acquisition of the business or the performance of future services by the seller.[sic] Do you believe that additional guidance is necessary for assisting in making this determination in an asset acquisition? If you believe additional guidance is necessary, please provide any factors that you believe should be considered in making this determination.**

We do not believe additional guidance in this area is necessary.

\* \* \* \* \*

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Lee Graul, National Director of Accounting, at (312) 616-4667 or Adam Brown, Partner in the National Accounting Department, at (214) 665-0673.

Very truly yours,  
/s/ BDO Seidman, LLP

---

<sup>5</sup> We note that practice will continue to develop with respect to whether or not specific transactions constitute the purchase of a business, as defined by Statement 141(R), which will influence how prevalent this inconsistency may become.