January 5, 2006

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

File Reference No. 1235-001

Dear Bob:

The Financial Reporting Committee of the Institute of Management Accountants is writing to provide its views on the Financial Accounting Standard Board's (FASB) Invitation to Comment, Selected Issues Related to Assets and Liabilities with Uncertainties. The financial reporting ramifications of the changes proposed by this project are fundamental – requiring broad changes to financial reporting processes, auditing standards and financial analysis. Importantly, we do not believe its application results in an improvement in financial reporting. As has been expressed in previous comment letters and discussions, we continue to struggle with an approach in which probability, a key component of the existing recognition principles, is effectively abandoned as a recognition trigger and only factored into the resulting measurement. The attached Exhibit 1 addresses each of the questions posed in the Invitation to Comment. The comments below represent our views on some of the more significant issues.

Despite the significance of the proposal underlying the Invitation to Comment, we are concerned that there will be minimal response from the FASB's constituents. We believe the fundamental nature and breadth of the proposed standard, combined with the number and significance of the FASB's other current standard setting projects, the Holiday season and the upcoming calendar-year financial reporting season, will not provide the FASB's broader constituency sufficient time to engage. Accordingly, we hope that a low response rate is not assumed to reflect a silent approval of the proposal.

The proposals underlying the Invitation to Comment are far reaching and have many interdependencies with the other significant standard setting projects, particularly revenue recognition, business combinations and financial performance reporting projects. Of course, it is difficult to fully evaluate the merits of the Invitation to Comment without a better understanding of the application of the proposed approach to the other standard-setting projects. Nevertheless, because we believe the underlying concepts of this document will form the underpinnings of the conceptual framework, and could cause a fundamental shift in the focus of portions of the
financial reporting model that have operated effectively for decades, we believe further progress must be achieved on the fundamental framework issues before the FASB proceeds on projects dealing with issues addressed in the Invitation to Comment. Accordingly, we believe that the business combinations and revenue recognition projects should not be completed until the FASB makes further progress against the Conceptual Framework project. However, it may be useful to test the application of the concepts to these areas as part of the deliberations to ensure the concepts translate appropriately into practical application.

FASB Standard Setting Process

As noted above, the financial reporting ramifications of the principles proposed by the Invitation to Comment are fundamental—requiring broad changes to financial reporting processes, auditing standards and financial analysis. We believe fundamental issues of this nature should be addressed in connection with the Conceptual Framework project. As discussed in our previous comment letters related to guarantees, asset retirement obligations, conditional asset retirement obligations and business combinations, we have been concerned that recent standard setting activities have or may impact key components of the conceptual framework on a piecemeal basis. Thus, we strongly believe a more holistic analysis of the framework is warranted. We also believe a change of this magnitude should be developed in coordination with the International Accounting Standards Board (IASB) to promote convergence on such an important topic. Importantly, we have provided our views to the IASB in our comment letter regarding IAS 37 (excerpts of which are included in Exhibit 2 to this letter). The views expressed in that letter are consistent with our views expressed herein.

Unfortunately, the Invitation to Comment was limited to a discussion of the IASB’s recent proposals without a discussion of alternative approaches. We believe this will limit the scope and usefulness of feedback received. If the FASB reframes this project into a Conceptual Framework discussion, that process would provide a broader discussion of alternative views that have been and should be considered so that constituents have a complete understanding of the fundamental changes proposed. Other alternatives for consideration could include the retention of the current SFAS 5 model or a change in the recognition threshold under the SFAS 5 model from “probable” to “more likely than not” so that contingent liabilities are recognized earlier in their progression. At the same time, a reconsideration of the recognition threshold for contingent assets could be considered—for example to probable or more likely than not to achieve symmetry with contingent liabilities. We have not developed views on the merits of these alternatives, but, we believe a more neutral analysis of the alternatives is essential and would improve the debate, thereby helping to reach the best conclusion for assets and liabilities with uncertainties.

We are troubled by the document’s failure to address and solicit feedback on what we believe is a key recognition threshold—the probability that a contingent asset will result in the receipt of an economic benefit or that a contingent liability will result in the sacrifice of an asset. We do not agree with the document’s characterization of how probability is factored into the definition of assets and liabilities in the FASB’s existing conceptual framework. Paragraph 8 of the Invitation to Comment appears to imply that probability is not a factor in triggering the recognition of an asset or liability in the current concepts statement. It indicates that the inclusion of the word “probable” in the definitions of assets and liabilities is intended simply to indicate that their existence is “not certain or proved.” We do not agree with this characterization and believe it does not fully capture all of the relevant language in the
footnote. This "paragraph 8" characterization of the Concept Statement definition of probable is critical because the recognition threshold for assets and liabilities is a fundamental underpinning of the document. In addition, the question of the meaning of "probable" in the definitions of assets and liabilities lies at the heart of recent debate between the Board and many of its constituents with respect to much of the Board's recent standard-setting activities relative to fair value accounting aspects in the projects on Business Combinations, Revenue Recognition, Asset Retirement Obligations and others.

Our reading of the Concepts Statements leads us to the conclusion that probability does indeed factor into both the determination of whether an asset or liability should be recognized in the financial statements and the measurement of the resulting asset or liability that is recognized. Concept Statement 6 defines assets as "probable future economic benefits obtained or controlled by an entity. Similarly, the concepts statements define a liability as "probable future sacrifices of economic benefits arising from past transactions." In both cases, footnote references (footnote 18 for the definition of assets and footnote 21 for the definition of liabilities) indicate that the term "probable" in this context is used as its general definition rather than its technical accounting sense (i.e., as in SFAS No 5) and refers to that which "can reasonably be expected or believed on the basis of available evidence but is neither certain or proved." We believe probability factors much more importantly in this context for the definition/threshold for recognition of assets and liabilities than is suggested by the reference in paragraph 8 to "simply...not certain or proved." Those same footnotes (footnotes 18 and 23) to Concept Statement 6 also refer to the definition in Webster's, which defines probable as follows:

1. supported by evidence strong enough to make it likely though not certain to be true,
2. likely to happen or have happened....(emphasis added)

While we acknowledge that this Concept Statement 6 threshold for general asset and liability recognition is different than the SFAS 5 threshold, our interpretation of this guidance is that any asset or liability must meet this general definition of probable (i.e., likely to occur, or more likely than not) before it is recognized. We fail to understand how one could conclude from the definition above how a contingent asset or liability whose probability of occurrence is less than 50% could meet this recognition threshold. We believe an approach that factors probability only into measurement is inconsistent with the current framework. We believe that any deviation from this framework needs to be fully addressed through a project subject to the Board's normal due process - not on a piecemeal basis through individual standards such as those dealing with contingent asset retirement obligations and contingencies in business combinations.

We are concerned that the paragraph 8 characterization of the Concept Statement 6 definition of probable (this incomplete definition of probable is repeated in paragraph 16 of the Invitation to Comment) is likely to lead most readers of the Invitation to Comment to conclude that the change to existing practice proposed by the IASB approach to accounting for contingent assets and liabilities is relatively benign when, in fact, it would be a fundamental and significant shift.

**Contingent Assets and Liabilities**

We do not believe that the application of this approach results in improved financial reporting relative to contingent assets and liabilities. Our views on this particular aspect of the Invitation to Comment remain consistent with our prior letters to the Board regarding asset retirement obligations and business combinations. Excerpts from these letters are attached as Exhibit 2 for
Measurement of uncertain assets and liabilities using the probabilistic cash flows model outlined in the Invitation to Comment is consistent with liquidation basis accounting in which assets and liabilities are remeasured at expected cash flows under an asset or liability held for sale approach. We do not believe that a theoretical valuation that effectively represents an exit value is the most relevant measurement attribute for uncertain assets or liabilities that a company has no intention to off-load.

We also do not believe the proposal will result in a more reliable or representationally faithful recognition/measurement of contingent assets and liabilities. We acknowledge that a significant amount of judgment is currently required to determine if a contingent liability reaches the “probable” recognition level under SFAS 5. We also acknowledge that same level of judgment would be required under any model that uses a threshold level as the trigger for recognition. However, we believe that potentially even more difficult and less objective judgments would be required in a model based on probability-weighted expected cash flows, since judgment is required both to estimate the various cash flow scenarios and to assign probabilities to those various scenarios. In the case of contingent liabilities that management believes are likely to result in actual liabilities, we believe the value under the SFAS 5 approach and the probabilistic cash flow approach will result in fairly comparable measurements, as the judgments will naturally congregate around management’s best estimate of the ultimate liability. However, we believe the probabilistic cash flow model will result in less relevant financial information for contingent liabilities that management believes are unlikely to result in actual liabilities – particularly when such liabilities are highly unlikely or remote. In these cases, companies will be required to record obligations against their better judgment, resulting in frequent and potentially significant reversals in subsequent periods. Thus on balance, we believe the current SFAS 5-based model is superior. This model, which could be based on the SFAS 5 definition of probable or using the general definition (i.e., likely or more likely than not), will result in comparable financial information to the probabilistic cash flow model for probable or likely contingent liabilities and more relevant information for unlikely contingent liabilities.

In any event, under a probabilistic cash flow model approach, users of the financial statements will presumably be required to refer to voluminous footnotes that provide perspective on the probabilistic fair value computations to understand the entity’s best estimate of future cash flows related to such assets and liabilities in order to analyze the entity’s going concern value.

**Differentiating between Conditional and Unconditional Items**

While we find the differentiation between conditional and unconditional assets and obligations to be intuitive for guarantees and frequently occurring obligations with similar characteristics such as warranty obligations, we struggle to apply this logic to other more unique business transactions, such as significant litigation, environmental issues, etc. We do not believe our reluctance to treat both sets of items consistently indicates the need for a different accounting model for the two types of items. Rather, we believe the differences are indicative of differing units of account. For frequently occurring obligations such as warranties, we would view the unit of account as the pool of sales that occurred during a given period – not an individual sales transaction. Because of the highly repetitive nature of the underlying pool of transactions and the history of related activities, we believe financial statement users, auditors and preparers alike are able to assess the likely obligations with a fairly high level of certainty. Conversely, the ultimate impact of a significant, unique litigation case cannot be estimated with any degree of accuracy because of the lack of comparable past transactions. In that context, recognizing an
asset or liability for this type of item, particularly when the likelihood of the litigation being successfully resolved is assessed as being unlikely (either from the perspective of the party bringing or defending the litigation), is troublesome.

The differentiation between conditional and unconditional assets in the three examples in paragraphs 33-35 seems contrived. The view that the specified unconditional rights (rights to the claim being heard by a court, to participate in the process of applying for the license, and to the economic value of the developing contractual relationship with the customer) represent assets is difficult to comprehend. The identified unconditional right seems philosophical and inconsistent with the underlying economics of the business transaction. Depending on one’s interpretation, the resulting scope could be incredibly broad, including any number of unforeseen and unconventional items that will be difficult to identify and value, potentially making the consistent application of the standard unattainable, not only within a company, but also across peer companies and different industries. In addition, we do not believe investors would find this accounting model particularly useful. Based on our interactions with the user community, we believe they would disregard any contingent assets recognized for unconditional rights to negotiate with customers, to apply for operating licenses, to file lawsuits and similar items. Further, we believe the earnings impacts of these assets would be confusing to some investors and ignored by those that understand the underlying accounting model.

We also struggle with the conclusions in paragraph BC9, wherein the IASB argued that any item subsumed within goodwill (i.e., any item for which the acquirer paid a price, but which itself does not qualify for recognition separately from goodwill) must itself satisfy the definition of an asset. We are concerned with asset recognition justifications based on elements identified within acquired goodwill. If the IASB believes the theoretical components of goodwill represent a collection of individual assets, would the proposed model require an entity to recognize assembled workforce or synergies as separable assets? Would this thinking be limited to business combinations or applied to internally-generated goodwill as well? Is there an underlying unconditional right for assembled workforce and synergies that represent an asset similar to the example involving the unconditional right to the economic value of the developing contractual relationship with a customer?

We believe that this conceptual approach will be very difficult to apply in practice as preparers, auditors and users analyze the completeness and consistency of an entity’s process to identify and differentiate unconditional and conditional rights. For example, should an entity differentiate rights between those that an entity can avail itself of and those that involve a relationship with a third party? Also, at what point along the continuum of an entity’s process of pursuing its unconditional right is an asset or liability created? Given the significant judgment inherent in this process, there will obviously be inconsistencies in how companies classify items. As a result, there is a high likelihood that certain of the Board’s constituencies would require significant implementation guidance to explain how to identify and differentiate underlying conditional and unconditional rights in numerous business transactions in order for the model to be operable. We believe that the level of implementation guidance that would be required indicates that the proposed model is not an intuitive approach to many business transactions and will not be operational.
Practical Difficulties to Determine Probabilistic Fair Value

While we respect the theory that probabilistic distributions of outcomes can approximate fair value for certain types of transactions, contingent assets and liabilities often do not lend themselves to observable market values because they are not frequently exchanged or sold. As demonstrated by the challenges associated with the adoption of standards such as FASB Statement No. 143 for asset retirement obligations, significant difficulties can result in practice from the application of such measurement principles. As expressed in our previous letters regarding asset retirement obligations and conditional asset retirement obligations, there continues to be significant difficulties and inconsistency in the valuation of asset retirement obligations. With this experience, we are very concerned if probabilistic valuation is applied more broadly to all contingent assets and liabilities. Our views on this matter are also expressed in our recent letters on the Board’s current exposure draft on Business Combinations.

Importantly, a probabilistic valuation to all business transactions may expose preparers and auditors to an unacceptable level of business risk when the lack of precision in the estimation process and the resulting balances and the resulting challenges relative to auditability are combined with the general legal environment in the area of financial reporting. We do not believe that expanded disclosure for the determination of fair value estimates necessarily provides the data for a financial reader to reconstruct the financial statements based on the best expectation of future cash flows.

In conclusion, we appreciate that the FASB is beginning to evaluate these fundamental issues, but believe it is critical that it be done in conjunction with the broader project to reevaluate the Conceptual Framework. While we struggle to conclusively evaluate the merits of the proposed approach to contingent assets and liabilities without a better understanding of its impacts on revenue recognition, business combinations, financial performance reporting and fair value disclosures, we do not believe the proposed approach represents an improvement in financial reporting. In addition, we believe that there will be significant difficulties to completely and consistently identify and differentiate unconditional and conditional rights. We believe additional research and analysis on this specific approach, as well as the related projects on revenue recognition and financial performance reporting, is warranted in the context of a project to assess the broader conceptual framework before the FASB proceeds under this proposed approach in any current or future standards.

If we can provide any additional perspective on our views, please contact me at (513) 983-3874.

Sincerely,

T. L. List
Chair, Financial Reporting Committee
Institute of Management Accountants
Responses to Individual Questions in Invitation to Comment

Question 1: Do you agree with eliminating the notion of contingent asset? If not, why not?

No. We believe that an entity’s assessment of the probability of future economic benefits is an important threshold for asset recognition. We struggle to understand how the recognition of less-than-likely future economic benefits provides improved financial reporting.

Question 2: Do you agree with the IASB’s analysis of unconditional and conditional rights in contractual settings, as summarized in paragraphs 30 and 31 of this Invitation to Comment and paragraphs BC10-BC13 of the IASB Exposure Draft? If not, why not?

No. The application of unconditional and conditional rights to nonfinancial contingent assets is counter-intuitive and difficult to consistently apply.

Question 3: If you answer yes to Question 2, do you agree that the IASB has appropriately applied the notion and supporting reasoning referred to therein in the analysis of Examples 1-3 in paragraphs 33-35 of this Invitation to Comment? If not, why not?

We believe that the identified assets in Examples 1-3 are not representative of the underlying economics of the business transaction. We believe that the current approach under SFAS 5 that focuses on the apparent conditional rights to determine recognition results in superior financial reporting.

Question 4: Do you agree with the IASB’s proposal to classify as intangible assets those unconditional rights that are associated with conditional rights and that satisfy the definition of an asset, without shifting the consideration of the uncertainty surrounding the conditional rights from recognition to measurement?

No. As noted in the body of our letter, we believe that the probability of the conditional rights resulting in future economic benefits is an important factor in triggering asset recognition. A standard that only factors uncertainty into measurement will not result in improved financial reporting.

Question 5: Do you agree with eliminating the notion of contingent liability? If not, why not?

No. We believe that the current approach under SFAS 5 that focuses on the probability of the conditional obligation results in improved financial reporting. We believe that current disclosure requirements for material, reasonably possible and remote contingent obligations provide sufficient information for users.

Question 6: Do you agree with the IASB’s analysis of unconditional and conditional obligations in contractual settings, as summarized in paragraphs 39 and 40 of this Invitation to Comment and paragraphs BC24-BC28 of the IASB Exposure Draft? If not, why not?
While we acknowledge that the distinction between unconditional and conditional obligations has proved to be a useful construct for resolving recognition issues related to guarantees and frequently occurring obligations with similar characteristics such as warranty obligations, we do not agree with the extension of this approach to other traditional contingent liabilities such as an individual lawsuit. Examples of the application of this approach included in the Invitation to Comment appear to us to be contrived.

*Question 7: If you answer yes to Question 5, do you agree that the IASB has appropriately applied the notion and supporting reasoning referred to therein in the analysis of the example in paragraph 41 of this Invitation to Comment? If not, why not?*

We struggle to understand how an entity would determine the probabilistic fair value for the unconditional obligation to stand ready to perform as directed by the courts and how this theoretical computation of reasonably possible or remote occurrences results in improved financial reporting.

*Question 8: Do you agree with omitting the probability criterion for recognition of nonfinancial liabilities? If not, why not?*

No. We believe that the determination of the probability of the future sacrifice of economic benefits is an important element of liability recognition.

*Question 9: Do you agree with the proposed measurement requirements for nonfinancial liabilities? If not, why not?*

No. We continue to struggle to apply current accounting requirements to determine the probabilistic fair value of asset retirement obligations and conditional asset retirement obligations. We are very concerned if this approach is applied more broadly.
Excerpts from Prior FRC Comments Letters Regarding Contingent Assets and Liabilities

IMA-FRC Comment Letter regarding IAS 37 dated October 6, 2005

While we respect the theory that probabilistic distributions of outcomes can approximate fair value for certain types of transactions, it does not necessarily follow that adopting such a theory for broad-scale use in the recognition and measurement of contingencies will represent an improvement to the financial reporting model. By definition, contingent assets and liabilities often do not lend themselves to observable market values because they are not frequently exchanged or sold. As demonstrated by the challenges associated with the adoption of standards such as FASB Statement No. 143 for asset retirement obligations, significant difficulties can result in practice from the application of such measurement principles. Importantly, such an approach may be prone to abuse and create additional challenges relative to auditability. The impact of the changes being proposed is far-reaching, and we believe additional research and analysis is warranted to ensure such a change will represent an improvement in financial reporting.

Given that FRC does not agree with the proposed changes to accounting for contingent assets and liabilities within the scope of a business combination, it is logical that we would not support such a change in the broader context proposed by the IASB. At a minimum, the IASB should not make such broad changes to the accounting model without the benefit of the full due process of the business combinations proposal – and possibly even some experience after adoption to evaluate its impact on financial reporting, if the current proposed approach to contingencies is not retained.

IMA-FRC Comment Letter regarding SFAS 143 dated September 8, 2004

We are requesting reconsideration of this standard because we are unable to determine the required measurement for certain types of asset retirement obligations, particularly obligations related to retirement activities that are conditional on an indeterminate future event occurring (“conditional obligations”). These obligations include but are not limited to, owned property for which there is no present requirement to begin remediation, removal of structures from leased property, and other similar retirement activities. It is simply not possible to measure the fair value of such conditional obligations with any degree of reliability. Moreover, if recognition were compelled by the issuance of the forthcoming Interpretation, it would not faithfully represent the true nature of the obligation. This is the case because there is no event or decision that makes the retirement of the asset probable in the foreseeable future and thus would enable companies to reliably estimate the timing or amount of cash flows. Because conditional obligations can often be postponed indefinitely, we typically do not know when retirement activities would commence, when they would be completed, what methods would be used to effect settlement, and other important information that is necessary to measure the obligation accurately.
IMA-FRC Comment Letter regarding FIN 47 dated July 30, 2004

We fundamentally disagree with the Board’s conclusion that the uncertainty surrounding the timing and method of settlement should be factored into the measurement of the liability at fair value, even when the retirement activity is conditional on a future event. In the examples cited by the interpretation, we believe that the conditional future event is the obligating event, not the act of contamination or the purchase of property containing asbestos. Further, we believe that a liability is not reasonably estimable until the uncertainties surrounding the timing and method of settlement are sufficiently clear that it is practicable to perform discounted cash flow scenarios with probabilities that are derived based on known facts, rather than on speculation.

Combined FRC/CCR Letter dated March 21, 2005 on the Financial Accounting Standards Board’s Staff Drafts (the “Drafts”) on Consolidated Financial Statements and Business Combinations (a revision of FASB Statement 141)

By definition, contingent assets and liabilities often do not lend themselves to observable market values because they are not frequently exchanged or sold. In fact, in paragraph B182 of the Basis for Conclusions in FAS 141 (which is a carryforward from paragraph 31 of FAS 38), the Board acknowledged that: “...the fair value of a preacquisition contingency usually would not be determinable.” We agree that certain contingent assets and liabilities’ fair values are determinable because they typically are supported by historical analysis, such as warranty and workers compensation insurance related reserves. However, we believe there are significant practice issues in the application of such a model to all contingent assets and liabilities. If such contingent items are based on observable market values, historical analysis or if, as described in footnote 14 of FAS 141, a contingency is used in determining the total consideration, then we believe that fair value would be determinable. However, for certain other less frequently occurring contingencies, such as litigation, environmental remediation and contractual claims, a FAS 5 model coupled with an appropriate allocation period enables preparers to evaluate and properly record these contingencies in the purchase price allocation. These contingencies, particularly legal claims, can be for significant amounts, are subjective in nature and often take years to resolve. For those contingencies where a fair value or probable amount cannot be determined in the allocation period, we believe that the contingency should be disclosed with any resolution, favorable or unfavorable, being recorded as a component of income.

We believe that most companies are using paragraph 40(b) of FAS 141 to account for their most subjective preacquisition contingencies. Because the Board is requiring fair value to be the only acceptable model for recording contingent assets and liabilities, it is likely that different companies will come to different conclusions regarding fair value of such contingencies. Companies will likely use the CON 7 expected cash flow approach, which is judgmental in nature and the inputs used (e.g., probabilities) are often incapable of being independently verified. In addition, since the fair value of the more subjective contingencies will be subsumed in the purchase price allocation based on an average of expected outcomes, the final outcome of the contingency will still need to be recorded and will create timing differences in the recognition of the ultimate resolution of these contingencies. Each of these issues, further discussed below, will result in significant practical issues to companies.
We believe that a CON 7 approach (expected present value) to fair valuing preacquisition contingencies is destined for future financial reporting headlines, whether the result of accounting misapplication or appropriate application of these principles, an important factual determination that may be difficult to reach in many circumstances. Importantly, we know that by definition, amounts assigned to contingencies will be wrong, since the amount recognized is extremely unlikely to equal the amount ultimately settled/realized. We do not see how this will aid financial statement users and suspect they would be troubled by this change. We also question the auditability of probabilities on what will often be some of the most subjective values analyzed in the acquisition. It is unclear how one could ever achieve the level of rigor required in the preparation of financial statements around the use of a probability applied to a potential scenario that is unlikely to occur. It is also unclear how an auditor would assess the reasonableness of such probabilities.

**Valuation Variability**

Contingent assets, as defined, would include contractual disputes and claims, patent applications, and, arguably, in-process research and development. We have included an example (Example 1 below - *Example not repeated for purposes of this exhibit*) of a situation related to a pool of outstanding contract claims whereby a reasonable fair value may be determinable because there is a past history of recovery. In other situations, such as a claim under a contract or a new patent, there may be no history upon which to rely. In these situations, a CON 7 expected cash flow approach would likely be used. Under the current model, such assets would not be recognized until realized.

In addition, the proposed guidance related to subsequent recognition of the assets categorizes them into intangible assets and financial instruments. We believe the Board should look further to see if all such assets would be deemed an intangible or a financial instrument. For example, a claim for reimbursement under a contract dispute may not be considered a financial instrument, nor would it be considered an intangible.

Contingent liabilities, as defined, would include normal and recurring operating accruals and accruals for the more judgmental areas, such as litigation, environmental remediation, and liabilities for removal of improvements at lease expiration. Operating accruals are typically recorded based on a past history of recurring outcomes and, therefore, are susceptible to a high degree of precision. For the more judgmental accruals, the ultimate outcome is often unclear. As a result, under a FAS 5 model, a liability is not recognized until the amount is deemed probable and estimable. As illustrated in Example 2 (*Example not repeated for purposes of this exhibit*) below, under a fair value approach, even if it is remote that a company would have to pay a $5 billion litigation claim, the fair value of the contingent liability would be recorded. Using a CON 7 expected cash flow approach, the company would record $500 million in purchase accounting and when the contingency is ultimately resolved the amount would be reversed into income. Alternatively, if it was highly probable that a $5 billion claim will be paid, the amount recorded in purchase accounting would be less than the probable liability because there is a slight chance such amount would not be paid. We believe that the current guidance, utilizing a FAS 5 model and disclosure provides a better and more operational model.

**Ongoing Income Statement Variability**

If it was the intent of the Board to record preacquisition contingencies sooner than they would have otherwise been recorded, this proposal does not necessarily achieve that goal. For example,
in a CON 7 expected cash flow approach, the asset or liability that is recorded is an average of expected outcomes, not the amount that is expected to be received or paid. As presented in Example 2 (Example not repeated for purposes of this exhibit) below, the expected outcome is zero, but under this proposed guidance $428.7 million would be recorded and subsequently reversed into income when the contingency is ultimately resolved. Under the FAS 5 model, if the probable amount was determined in the allocation period, that amount would be recorded in purchase accounting. If it was not determinable, the amount would be disclosed.

If the Board ultimately concludes that fair value is the only acceptable model, we do not believe that such preacquisition contingencies should be adjusted to fair value each period but rather should be subject to adjustment based on changes or triggering events, not simply passage of time.